S. HRG. 101-180

THE IMPACT OF SECTION 89, I.R.C., ON SMALL BUSINESS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

THE IMPACT OF SECTION 89, I.R.C., ON SMALL BUSINESS

APRIL 13, 1989

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HEARING DATE

April 13, 1989:

Morning session 1

THE IMPACT OF SECTION 89, I.R.C., ON SMALL BUSINESS

THURSDAY, APRIL 13, 1989

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to notice, at 9:42 a.m., in Room SR 428A, Russell Senate Office Building, Hon. Rudy Boschwitz and Hon. David Boren (Acting Chairmen) presiding.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator BOSCHWITZ. Senator Boren and I would like to call to order this oversight hearing concerning the impact of Section 89 on small business.

I have a brief statement, I assume that some of the other Senators do as well. At the conclusion of this statement we will be pleased to hear testimony from the witnesses. In that regard, I note that we have an impressive list of witnesses. We request that you do your best to limit your oral testimony to 5 minutes in order to leave adequate time for all the witnesses, to ensure time for questions.

And please do try to pick out the highlights, because otherwise we will have a repetition of the same type of testimony.

As you know, Section 89 was incorporated in the Tax Reform Act of 1986 with the stated purpose of encouraging employers to provide health and life insurance benefits to their employees at all levels of employment income.

I was very actively involved in the tax reform effort, even though I was not a Member of the Finance Committee, but I must tell you I heard nothing about Section 89 at that time. And in conversation with other Senators, I have found that no one really knew of its existence at the time the bill passed in 1986.

Frankly, having studied this legislation at great length, and visited with hundreds of small business owners about it, even if I had known it was there, because it was so complicated, I am not sure I would have gotten the implications right off hand, or that flags would have been raised.

I might say that Section 89 is really very poignant testimony to the necessity of a line item veto.

One other point is worth noting, most of the debate over Section 89 is focused on its impact on the business community. Many people do not realize that State and local governments also are obligated to comply. It is probably a great surprise to many State and local government employees that they are regarded as highly compensated, even though, by all reasonable standards, their level of income is quite modest.

But as you know, Section 89 mandates that at least one person in each employment entity be regarded as highly compensated for testing purposes. That we are here today is clear evidence that Section 89 is a serious problem. And it is a problem, I believe, for two distinct reasons.

First, it is extremely complex, and therefore it is going to be difficult and expensive to comply with. And already we are hearing some employers are spending as much as $5,000 for computer programs, and additional thousands in employee time and consulting fees.

And these are dollars, I might add, which could be used to make the business more profitable.

Second, Section 89 is a problem because it is causing great frustration for the people who want to obey the law and meet their tax obligation, but simply do not know how to go about it.

We in Congress sometimes make it so tough for people to comply that they are forced to ignore or perhaps even cheat, with respect to the law. This has a negative impact generally on the public's willingness to comply voluntarily with legislation in general.

Let us be clear about one point. I do not for 1 minute believe critics of Section 89 advocate discrimination in any aspect of the employer-employee relationship. Rather, we have been hearing from small business owners and representatives of State and local government who are grasping for a solution to a problem they had no part in creating.

They truly want to do what is right for their employees, and I know that is true because we certainly do in the businesses that we run.

The goals of Section 89 sound simple to attain: Increased health insurance coverage and fairer tax treatment for employees. But gathering all the data and figuring out exactly what is required to prove the absence of discrimination is clearly very difficult.

On top of the statute's complexity, we now have regulations from the IRS which were released 3 months ago and ran about 200 pages. That is pretty serious stuff.

And some parts of the statute still have no regulations.

For example, sections pertaining to the valuation of multi-employer plans and life insurance. If the IRS has problems figuring out what the statute means, how can we reasonably expect small employers to wade through it.

In many cases, I am afraid business owners will find it easier and more cost-effective simply to refuse to comply with the law and impute any excess benefits as income to their highly-paid employees.

Some small employers will reduce or even eliminate the benefits they now provide. And those that do not provide health benefits will be further discouraged from doing so. This may be a whole effort to raise some money on the side, because it may just become easier for employers to say that their high-level employees are OK. We are just going to add to your income by a few dollars.

I appreciate the efforts of the thousands of small business owners who have contacted their elected representatives to bring this issue to our attention. And without their persistence, this hearing might not be taking place.

I look forward to the testimony, and I turn now to Senator Boren.

[The prepared statement of Senator Boschwitz follows:]

OPENING STATEMENT OF SENATOR RUDY BOSCHWITZ
OVERSIGHT HEARING OF THE SENATE SMALL BUSINESS COMMITTEE
REGARDING SECTION 89 OF THE INTERNAL REVENUE CODE
APRIL 13, 1989

SENATOR BOREN AND I WOULD LIKE TO CALL TO ORDER THIS OVERSIGHT HEARING CONCERNING THE IMPACT OF SECTION 89 ON SMALL BUSINESS.

I HAVE A BRIEF STATEMENT, AS DOES, I ASSUME, SENATOR BOREN. AT THE CONCLUSION OF THE STATEMENTS, WE WILL BE PLEASED TO HEAR TESTIMONY FROM THE WITNESSES. IN THAT REGARD, I NOTE THAT WE HAVE AN IMPRESSIVE LIST OF WITNESSES. WE REQUEST THAT YOU DO YOUR BEST TO LIMIT YOUR ORAL TESTIMONY TO ABOUT FIVE MINUTES, IN ORDER TO LEAVE ADEQUATE TIME FOR ALL THE WITNESSES AND TO ENSURE TIME FOR QUESTIONS.

AS YOU KNOW, SECTION 89 WAS INCORPORATED INTO THE TAX REFORM ACT OF 1986 FOR THE STATED PURPOSE OF ENCOURAGING EMPLOYERS TO PROVIDE HEALTH AND LIFE INSURANCE BENEFITS TO THEIR EMPLOYEES, BOTH THE UPPER AND LOWER INCOME EMPLOYEES. I WAS VERY ACTIVELY INVOLVED IN THE TAX REFORM EFFORT, EVEN THOUGH I AM NOT A MEMBER

OF THE FINANCE COMMITTEE. BUT I MUST TELL YOU I HEARD NOTHING ABOUT SECTION 89 AT THAT TIME. IN CONVERSATIONS WITH OTHER SENATORS I HAVE FOUND NO ONE WHO KNEW OF SECTION 89'S EXISTENCE AT THE TIME TAX REFORM PASSED IN 1986.

FRANKLY, HAVING NOW STUDIED THIS LEGISLATION AT GREAT LENGTH, AND VISITED WITH HUNDREDS OF SMALL BUSINESS OWNERS ABOUT IT, EVEN IF I HAD KNOWN IT WAS THERE, BECAUSE IT IS SO COMPLICATED, I'M NOT SURE I COULD HAVE DETERMINED ON MY OWN ITS IMPLICATIONS FOR SMALL BUSINESS.

ONE OTHER POINT IS WORTH NOTING. MOST OF THE DEBATE OVER SECTION 89 HAS FOCUSED ON ITS IMPACT ON THE BUSINESS COMMUNITY. MANY PEOPLE DON'T REALIZE THAT STATE AND LOCAL GOVERNMENTS ALSO ARE OBLIGATED TO COMPLY. IT'S PROBABLY A GREAT SURPRISE TO MANY STATE AND LOCAL GOVERNMENT EMPLOYEES THAT THEY ARE REGARDED AS "HIGHLY COMPENSATED," EVEN THOUGH BY ALL REASONABLE STANDARDS THEIR LEVEL OF INCOME IS QUITE MODEST. BUT AS YOU KNOW, SECTION 89 MANDATES THAT AT LEAST ONE PERSON IN EACH EMPLOYMENT ENTITY BE REGARDED AS HIGHLY COMPENSATED FOR TESTING PURPOSES.

THAT WE ARE HERE TODAY IS CLEAR EVIDENCE THAT SECTION 89 IS A SERIOUS PROBLEM. AND IT IS A PROBLEM, I BELIEVE, FOR TWO DISTINCT REASONS: FIRST, IT IS EXTREMELY COMPLEX. THEREFORE, IT IS GOING TO BE VERY DIFFICULT AND EXPENSIVE FOR EMPLOYERS TO COMPLY WITH ITS STANDARDS. ALREADY WE ARE HEARING THAT SOME

EMPLOYERS ARE SPENDING AS MUCH AS $5000 FOR COMPUTER PROGRAMS AND ADDITIONAL THOUSANDS OF DOLLARS IN EMPLOYEE TIME AND CONSULTING FEES. THESE ARE DOLLARS, I MIGHT ADD, WHICH COULD BE USED TO MAKE THE BUSINESS MORE PROFITABLE.

SECOND, SECTION 89 IS A PROBLEM BECAUSE IT IS CAUSING GREAT FRUSTRATION FOR PEOPLE WHO WANT TO OBEY THE LAW AND MEET THEIR TAX OBLIGATIONS, BUT SIMPLY DON'T KNOW HOW TO DO IT. WE IN CONGRESS SOMETIMES MAKE IT SO TOUGH FOR PEOPLE TO COMPLY THAT THEY ARE FORCED TO CHEAT OR IGNORE THE LAW ALTOGETHER. THIS HAS A NEGATIVE IMPACT GENERALLY ON THE PUBLIC'S WILLINGNESS TO COMPLY VOLUNTARILY WITH OTHER LEGISLATION.

LET'S BE CLEAR ABOUT ONE POINT. I DON'T FOR ONE MINUTE BELIEVE CRITICS OF SECTION 89 ADVOCATE DISCRIMINATION IN ANY ASPECT OF THE EMPLOYER-EMPLOYEE RELATIONSHIP. RATHER, WE HAVE BEEN HEARING FROM SMALL BUSINESS OWNERS AND REPRESENTATIVES OF STATE AND LOCAL GOVERNMENT WHO ARE GRASPING FOR A SOLUTION TO A PROBLEM THEY HAD NO PART IN CREATING. THEY TRULY WANT TO DO WHAT'S RIGHT FOR THEIR EMPLOYEES. I KNOW THAT WAS TRUE FOR ME WHEN I RAN MY SMALL BUSINESS IN MINNESOTA BEFORE COMING HERE TO THE SENATE.

THE GOALS OF SECTION 89 SOUND SIMPLE TO ATTAIN -- INCREASED HEALTH INSURANCE COVERAGE AND FAIRER TAX TREATMENT FOR EMPLOYEES. BUT GATHERING ALL THE DATA AND FIGURING OUT WHAT EXACTLY IS

REQUIRED TO PROVE THE ABSENCE OF DISCRIMINATION IS CLEARLY VERY DIFFICULT.

ON TOP OF THE STATUTE'S COMPLEXITY WE NOW HAVE REGULATIONS FROM THE IRS, WHICH WERE RELEASED THREE MONTHS AFTER SECTION 89 TOOK EFFECT AND RUN TO ABOUT 200 PAGES. AND SOME PARTS OF THE STATUTE STILL DO NOT HAVE REGULATIONS: FOR EXAMPLE, SECTIONS PERTAINING TO THE VALUATION OF MULTIEMPLOYER PLANS AND LIFE INSURANCE. IF THE IRS HAS PROBLEMS FIGURING OUT WHAT THE STATUTE MEANS, HOW CAN WE REASONABLY EXPECT SMALL EMPLOYERS TO WADE THROUGH IT.

IN MANY CASES, I'M AFRAID BUSINESS OWNERS WILL FIND EASIER AND MORE COST-EFFECTIVE SIMPLY TO REFUSE TO COMPLY WITH THE LAW AND IMPUTE ANY EXCESS BENEFITS AS INCOME TO THEIR HIGHLY-PAID EMPLOYEES. SOME SMALL EMPLOYERS WILL REDUCE OR EVEN ELIMINATE THE BENEFITS THEY NOW PROVIDE, AND THOSE THAT DO NOT PROVIDE HEALTH BENEFITS WILL BE FURTHER DISCOURAGED FROM DOING SO.

I APPRECIATE THE EFFORTS OF THE THOUSANDS OF SMALL BUSINESS OWNERS WHO HAVE CONTACTED THEIR ELECTED REPRESENTATIVES TO BRING THIS ISSUE TO OUR ATTENTION. WITHOUT YOUR PERSISTENCE, THIS HEARING MIGHT NOT BE TAKING PLACE. I LOOK FORWARD TO THE TESTIMONY OF THE WITNESSES.

STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM THE STATE OF OKLAHOMA

Senator **Boren**. Thank you very much, Senator Boschwitz.

It is a privilege to join with you today in a bipartisan call for these hearings. And I want to express my appreciation to Chairman Bumpers, Chairman of the full Committee, who agreed to allow us to conduct these hearings on a very important subject to small businesses across the country.

Quite simply, we are here today because Section 89, as currently drafted, fails completely to recognize the realities of the real working world.

Over the past 6 months I have heard from literally thousands of small business employers in my home State expressing their dismay with Section 89. Employers have rightfully complained that the new testing requirements are needlessly complex.

Employers must incur thousands of dollars of costs, only to be told that their welfare and health plans do not discriminate, a fact which they already know.

Attorneys and benefit advisors are puzzled by the complexity of this new tax code section, which prohibits discrimination against rank-and-file employees in the areas of health and life insurance benefits.

Many are demanding its repeal or, at the very minimum, a significant delay in the effective date to allow time to decipher the new code requirements.

Their demands have not gone unheeded. We are here today to address this problem. The Finance Committee, on which I also serve, I am happy to report, has also scheduled similar hearings on Section 89, which will be conducted on May 9. There is a growing sentiment in that Committee to do something to either delay the regulations, change the effective provisions of the act, or repeal it altogether.

The arguments against Section 89 as now drafted are compelling. Discrimination with employee benefits is the exception rather than the rule. Why, then, the wholesale changes in the Internal Revenue Code to address this infrequent discrimination?

The complexity of these rules may well prove to be counterproductive to the stated goals of Section 89. I would submit that the current rules will work against our health policy goals of expanding health insurance coverage and restraining the increasing cost of health care.

Most of the small businessmen and businesswomen that I have talked with have stated directly that they would rather drop the coverage rather than run the risk of following Section 89 rules.

This certainly is not the intent of Congress. How ironic it would be, because of unnecessary bureaucratic entanglements, frightening penalties, making it impossible for small businesses to know whether or not they are in compliance, that they would decide to drop all their health benefits altogether rather than run these risks.

I am convinced we are going to end up with millions of Americans without health insurance, who now have health insurance, because of the very improper way in which Section 89 was drafted.

The problems with Section 89 are myriad in number. The most basic and pressing problems involve a qualification rule, with an inexplicable atom bomb penalty for innocent employees. Employees who are certainly not even involved in making the decisions if plans are disqualified, will find themselves paying huge tax penalties.

Now how in the world can this be justified?

The counting of part-time employees is unnecessarily complex, an extremely burdensome requirement to track and keep records on former employees, the unwillingness to accept safe-harbor rules that would materially ease the testing, and the lack of truly simple testing alternatives for small firms, and an insistence on data gathering that is both costly and of dubious value.

There are many, many problems with Section 89 as it now stands. Perhaps the answer lies in the fundamental basis for non-discrimination rules. If the basis for past congressional action, as some have stated, was the premise that employers are willfully discriminating against their employees, then it may be best just to repeal Section 89 outright, because as I have said, I think it is the exceptional situation where we have intentional discrimination.

I would reject any kind of indictment of small businesses on a massive scale.

If the premise was, as others have suggested, the legitimate concern that Congress, having granted $40 billion a year in tax expenditures for employee benefits, has an obligation to taxpayers to assure that these tax expenditures are delivering employee benefits on a broad cross-section approach, then we have an obligation not to throw in the towel, but rather to work to fashion a reasonable set of non-discrimination rules that reflect the real world, as opposed to what we now have in Section 89.

I have co-sponsored several different proposals that are before us. I have co-sponsored S. 89, introduced by Senator Symms, who I see has just arrived, calling for a delay in the implementation date; S. 350 introduced by Senator Lott, which calls for repeal of Section 89.

We have S. 595 introduced by Senator Domenici, which provides for a small business exemption from Section 89. And I have also co-sponsored S. 654 by Senator Pryor, which calls for a number of changes and the simplification of this section to make it more workable.

Senator Pryor's bill would be a first step toward simplifying Section 89. Among other things, S. 654 creates a model simplified health arrangement under which an employer does not have to perform the Section 89 non-discrimination rules if its health arrangement is available to at least 90 percent of its employees and mandatory employees contributions are limited.

This bill expands the rule for testing part-time employees from the current 17.5 hours to 30 hours in 1989. And additionally, the bill would repeal what I have referred to as the atom bomb penalties for failure to meet the qualification standards of the current Section 89.

And finally, it would exempt non-profit and local government groups without highly compensated employees.

So, Mr. Chairman, I want to congratulate you for your leadership in this matter, and your interest in having this committee address this subject. It has been a pleasure to work with you on a number of other matters of mutual importance to our States and to the country.

I look forward to hearing the witnesses today. I especially want to welcome Terry Neese, the director of small business for the Oklahoma State Chamber of Commerce, who will also be testifying as one of the witnesses today.

And again, I commend you for your leadership.

[The prepared statement of Senator Boren follows:]

STATEMENT OF SENATOR DAVID BOREN:

Mr.Chairman:

I commend you and Senator Bumpers for calling this hearing today that begins the process of reconsideration of Section 89 in the Senate. Quite simply we are here today because Section 89, as currently drafted, fails completely to recognize the realities of the working world.

Over the past six months I have heard from literally thousands of Oklahomans expressing their dismay with Section 89. Employers have rightfully complained that the new testing requirements are needlessly complex. Employers must incur thousands of dollars of cost only to be told that their welfare and health plans do not discriminate - a fact they knew before they started!

Attorneys and benefit advisors are puzzled by the complexity of this new tax code section which prohibits discrimination against rank and file employees in the area of health and life insurance benefits. Many are demanding its repeal, or at a minimum, a significant delay in the effective date to allow time to decipher the new code requirements. Their demands have not gone unheeded as we are here today to address this problem and the Finance Committee has now scheduled similar hearings on Section 89 on May 9th.

The arguments against Section 89 as drafted is compelling. Discrimination with employee benefits is the exception rather than the rule. Why then the wholesale changes in the Internal Revenue

Code to address this infrequent discrimination? The complexity of these rules may well prove to be counter productive to the stated goals of Section 89. I would submit that the current rules will work against our health policy goals of of expanding health insurance coverage and restraining the increasing cost of health care. Most of the small businessmen and women I have talked with in Oklahoma have stated directly that they would rather drop their coverage than run the risk of failing current Section 89 rules. Is this really the intent of Congress? I certainly hope not.

The problems with Section 89 are myriad in number and mind-numbing in complexity. The most basic and pressing problems involve a qualification rule with an inexplicable atom bomb penalty for innocent employees, counting part-time employees, an extremely burdensome requirement to track and keep records on former employees, the unwillingness to accept safe harbor rules that would materially ease the testing, the lack of a truly simple testing alternative for small firms, and an insistence on data gathering that is both costly and of dubious value. Whether each of these complaints can be addressed in such a fashion as to allow employers to successfully test their health and life insurance plans remains to be seen.

Perhaps the answer lies in the fundamental basis for non-discrimination rules. If the basis for past Congressional action was, as some have stated, the premise "that employers are willfully discriminating against their employees", then, it may be best to repeal Section 89, because I will not support such an indictment of America's small businesses. If, however, the premise was, as others have suggested, "the very legitimate concern that Congress, having granted $40 billion a year in tax expenditures for employee benefits, has an obligation to taxpayers to assure that these tax expenditures are delivering employee benefits to a broad cross-section of employees", then we have an obligation not to throw in the towel, but rather to work to fashion a reasonable set of non-discrimination rules that reflect the real world.

I subscribe to the latter belief. Towards that end I was an original cosponsor of S. 654, the Section 89 Simplification Act which was introduced by my colleague Senator Pryor. I think we all recognize that this legislation is just the first step in the process of simplifying Section 89. Among other things S. 654 creates a Model Simplified Health Arrangement under which an employer does not have to perform the section 89 nondiscrimination rules if its health arrangement is available to at least 90 percent of its employees and mandatory employee contributions are limited. This bill also expands the rule for testing part-time employees from the current 17 and 1/2 hours to 30 hours in 1989. Additionally the bill would repeal the "atom bomb" penalties for failure to meet the qualification standards of the current section 89. And finally under S. 654 nonprofit organizations and local governments without highly compensated employees would be exempted from section 89 testing.

Mr. Chairman, again I thank you for calling these hearings and I look forward to hearing from today's witnesses especially Terry Neese, the Director of Small Business for the Oklahoma State Chamber of Commerce and Industry.

Senator BOSCHWITZ. Thank you very much, Senator Boren.

Senator Kasten.

STATEMENT OF HON. ROBERT W. KASTEN, JR., A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator KASTEN. Mr. Chairman, thank you.

I would like to associate myself with the views of the Chairman and also the gentleman from Oklahoma, in terms of the problems that we have got with Section 89.

I would ask unanimous consent to make my entire statement part of the record. And I would also ask unanimous consent to include a number of letters, which I have received from throughout the State of Wisconsin, in opposition to Section 89, so that people can recognize the grassroots nature of the opposition to Section 89.

This is not a regional issue, it is a national issue. It is the No. 1 small business issue across the country right now. I would not even call it an issue. I think it is the No. 1 small business problem right now. And we have got to work to change it.

Yesterday we had the opportunity, for the first time, on the Floor of the Senate to change it. We first had an amendment from Mr. Lott and Mr. Symms, and a number of us that were co-sponsors, and that passed 98 to nothing. That shows the concern, or at least how many people want to be at least on record opposed to Section 89.

All of us have been putting our names on the various bills to repeal or delay, but then we had the next vote. The next vote was to really do something. The next vote was an amendment that would delay Section 89 until January 1, 1990. On that vote, the leadership of the Finance Committee opposed my amendment, to knock it out.

And unfortunately, because we had to go through a parliamentary situation to get a super majority, the vote of 56 to 42, which was our vote, although we were in the majority, we did not get the 60 votes we needed to get to.

I predict today we are going to delay or knock out Section 89, and we are going to do it within the next month or two. We cannot go through hearings on this process and keep small businessmen and businesswomen across this country in limbo as to what they are going to be under and what they are not going to be under.

We have got to say that, No. 1, do not worry about it for this year. That is the first responsibility for Congress. And the second responsibility for Congress is to knock it out. And if we cannot knock it out, we have got to work with the simplification proposals that Mr. Pryor has come up with and some of the other proposals that some other people have come up with.

But, yesterday we faced a simply impossible situation on the Floor of the Senate. One person said the revenue that was going to be lost was $70 million. Another person said it was $130 million. Another person said it was $150 million. Another person said it was $300 million that we were going to lose in revenue.

I was placed in the position of having to oppose a budget amendment when no one on the Floor of the Senate could say how much revenue was going to be gained. And no one recognized the fact that, whether it is $70 million, $130 million, $150 million, or $300 million, the cost of small business to comply with this is going to offset even the $300 million.

The cost to small business to comply with this, and those are dollars that are going to be spent against the budget deficit, could be close to $1 billion.

So we are going to fight this battle. We are going to fight the revenue estimates, we are going to fight the effort. And we are going to be successful. I am convinced that we are going to repeal Section 89, and I am convinced that small business will not have to worry about Section 89 for this tax year.

I just hope the Senate and the Congress will step up to the ball and put all of us on record so that people do not live in this kind of limbo that they have found themselves in.

[The prepared statement of Senator Kasten follows:]

OPENING STATEMENT ON SECTION 89
BY U.S. SENATOR BOB KASTEN (R-WIS)
APRIL 13, 1989

Mr. Chairman, it is a pleasure for me to be here today as the Small Business Committee reviews the impact of Section 89 of the Internal Revenue Code on the small business community.

I am glad to see such a wide array of witnesses, gathered from all across the country. This is important, because Section 89 isn't a regional issue, or even purely a small business issue. Its a national issue. More specifically, its a national problem.

And it is a problem which must be dealt with immediately. Congress is finally recognizing what the business community of America has known for some time. The Section 89 regulations, as currently written, are totally unacceptable.

Mr. Chairman, I favor the repeal of these regulations, and I question whether additional new non-discrimination rules are truly needed. I look forward to a serious discussion of this issue, and the devastating impact that Section 89 is having on the small business community.

I will not recount the horror stories I have heard at this time. I am convinced today's witnesses will do a convincing job of making clear just what a nightmare Section 89 is.

Congress will soon take the sensible step of either repealing or delaying the Section 89 regulations. Just yesterday, important votes took place on the Senate floor on this issue. The Lott-Symms Sense of the Senate amendment was approved unanimously. And my amendment to delay for one year the implementation of Section 89 received 56 votes, just four votes short of the amount needed to delay these regulations.

I am convinced that soon we will be successful. Today's hearing is invaluable in that regard, because we are about to make it crystal clear to those still in doubt that Section 89 must be stopped.

Thank you, Mr. Chairman.

ROBERT G. ALEXANDER
ATTORNEY AT LAW
N88 W16848 MAIN STREET
MENOMONEE FALLS, WISCONSIN 53051
(414) 251-9440

Letter Cancel

April 7, 1989

-89

Senator Robert W. Kasten
110 Hart Senate Office Building
Washington, D.C. 20510

Re: Internal Revenue Code Section 89

Dear Senator Kasten:

Thank you for your letter of March 20, 1989 discussing your proposals to introduce legislation to stop the implementation of Section 89 of the Internal Revenue Code.

As with all recent legislation with respect to employee benefits I am deeply shocked and grieved that our government continues to draft legislation which only serves to decrease the benefits which are available to the rank and file employee.

Because of the exceedingly complex provisions of Section 89 and also because of the constant revision of the employee benefit statutes almost all of my clients (and I represent a great number of small businesses) have cancelled coverage of all employee benefits. This is a tragedy. Rather than helping employees obtain fair benefits, this legislation has done just the opposite by forcing employers to cancel all benefits entirely.

Good luck with your attempts to return sanity to the area of employee benefits.

Sincerely yours,

Robert G. Alexander

RGA:cjd

HANSEN'S DAIRY, INC.
Quality Dairy Products & Ice Cream

GREEN BAY, WIS. 54302
1756 University Avenue
(414) 437-0551

April 10, 1989

Tell '89
Cancel

Bob Kasten
110 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Kasten:

I am the president of Hansen's Dairy Stores, Inc. and have been working on a health insurance program for our 160 employees which half are part time.

After two classes on section 89, I have concluded it is best to drop the whole idea.

Sincerely,
HANSEN'S DAIRY STORES, INC.

Howard C. Hansen
Howard C. Hansen

MARCH 14, 1989

SEN BOB KASTEN
US SENATE
WASHINGTON, DC 20510

DEAR MR. KASTEN:

I AM WRITING SPECIFICALLY ABOUT IRS SECTION 89. I OWN TWO BOWLING CENTERS IN WISCONSIN AND AN INSURANCE AGENCY. I FEEL THIS TYPE OF REGULATION IS INJURIOUS TO SMALL BUSINESS. I WILL, TO FOLLOW THIS IRS LAW AND COMPLY, NEED TO ELIMINATE MY GROUP HEALTH INSURANCES FOR MY EMPLOYEES. I HAVE ANXIOUSLY BEEN WAITING TO SEE IF THIS WAS GOING TO BE OVERTURNED.

I AM SURE THAT YOU ARE AWARE OF THE BILL S.350 WHICH WOULD REPEAL THIS BURDENING LEGISLATION. I WOULD URGE YOUR SUPPORT.

SINCERELY,

Edward m Hellenbrand

EDWARD M HELLENBRAND
510 WEST ST. OR
P.O. BOX 7
WAUNAKEE, WI. 53597

Senator BOSCHWITZ. Thank you, Senator Kasten.

Senator Baucus, I know that you have another meeting.

STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Chairman, I think it is important to put this provision in perspective.

The fact is that Section 89 was really born in the Tax Reform Act in 1986. In 1984 and 1985, Treasury suggested various approaches in tax reform to come up with what they thought was an effective non-discrimination rule. And that provision was then incorporated in the Tax Reform Act of 1986.

At that time, as you said, Mr. Chairman, we did not hear very much from the small businesses or from businesses generally, who had to comply with the Section 89 provisions. But we started to hear a little bit. In fact, last year in the Technical Corrections Act, we loosened Section 89 slightly. Those were the first, sort of, vanguard complaints we heard from small business people, and from businessmen generally.

It has been very clear to us, however, that since then, since last year, when companies had to start to conform with Section 89, that the problem is much worse than anybody anticipated.

In fact, it is so far out of hand, as Senator Boren said, and as all of us know, that there are many companies who are terminating their benefit plans because they just cannot comply. It is also clear that they have unnecessarily complex regulations to comply with.

The fact of the matter is, this is a Section 89 compliance manual. It is over 300 pages. And it is added to every month. And it just seems a bit outrageous that a business person would have to go through all of this just to comply with one section of the Code, let alone all the other sections of the Code.

And I hear that it takes at least 40 hours just to learn Section 89. Obviously it could take a lot longer than that, because you have to keep learning it because you have to keep current, as all the new regulations come out.

It just seems to me that the obvious answer is to either repeal Section 89, drastically modify it, or delay it. As Senator Boren said, the Chairman of the Finance Committee, Senator Benson, has publicly announced that he will hold hearings. He has also said that he will also agree to major surgery to Section 89.

I hope at this hearing we can hear from business people, from the IRS, to determine the degree to which we can drastically conduct drastic surgery on Section 89, because that would be very useful to the Finance Committee. Senator Boren is on the Finance Committee, I am on the Finance Committee, I think there are several others here, I do not see anybody now, who are on the Finance Committee. Senator Symms, our primary witness, is on the Finance Committee.

And I can guarantee to those business people who are concerned about Section 89, that all of us on that Committee will see to it that Section 89 is drastically modified, drastically simplified, and if that cannot be done, that we will delay it or repeal it.

Thank you, Mr. Chairman.

Senator **Boschwitz**. I thank you, Senator. And the interest in Section 89 is certainly reflected by the large attendance at the Committee hearing this morning.

My apologies to Senator Symms, but we will continue with opening statements.

Senator, do you have the time to wait?

Senator **Symms**. My time is yours, Mr. Chairman.

Senator **Boschwitz**. Does any Senator who is present——

Senator **Symms**. I might make a parliamentary inquiry. How is it that we have a Republican Chairman of this Committee?

Senator **Boren**. We take a very American, bipartisan point of view in this committee. He promised the Chairman 10 votes on other issues. [Laughter.]

Senator **Boschwitz**. We will proceed to Senator Grassley. I asked for this hearing, Senator Symms.

Senator **Symms**. I am proud of you for it.

Senator **Grassley**. I am not going to apologize to Senator Symms, because I listen to him an awful lot when I am at the witness table. [Laughter.]

STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **Grassley**. Now business in Iowa is small business; 27 percent of our workforce is employed by businesses of 19 employees or less. And the problem that we have of 13 percent of our workforce in Iowa not being covered by health insurance is not going to be helped by this legislation now on the books, it is going to be hindered.

Like all of my colleagues, I received the same outpouring of protests from my constituents on Section 89. I have not received one letter in support of Section 89. And it is easy to understand why the mail is so overwhelmingly negative.

If there is anything that we ought to be able to do in Congress, it is to write laws that invite regulations that are understandable by the people who have to carry them out.

If they are not understandable, I think that they are bad legislation.

The punitive aspects of this bill are onerous. And given that many employers could remain out of compliance despite their best efforts to bring themselves into compliance, the penalties are unreasonably severe. It is absolutely ridiculous that in the event a plan is out of compliance with qualification standards that an ordinary employee could be taxed on the value of health insurance payments they received, a decision they have nothing to do with, but they pay the penalty.

I have yet to learn whether we know that there is really a problem out there in the economy of a magnitude warranting a step as draconian as this Section 89.

I would like to have, at the end of this hearing, somebody tell me what the problem is that we are trying to fix with this program. Perhaps the Treasury witnesses will be able to enlighten us on this question.

A related question is, what was the constituency for this provision? Usually on problems that we address here in the Congress we have heard from interested parties calling our attention to the existence of a problem and laying out its dimensions, and perhaps a solution, or we find a solution.

But I am simply unaware of any grand groundswell of concern over the problems and questions that this bill or this legislation, Section 89, is addressing.

Mr. Chairman, one of the fears that is presently discussed with respect to Section 89 is that many employers are going to cancel their employee benefit programs rather than undertake the complex data gathering and testing procedures required, and rather than run any risk of non-compliance.

I do not know whether this is happening, Mr. Chairman, or not, but if that is the end result of it, that is not going to help the situation of 13 percent of the people in my State not having health insurance, it is going to make it worse.

Out of a hearing like this, I hope we can build a record to support repeal. If we cannot do that, let's build a record to reform it so it is workable, understandable, and can be complied with.

[The prepared statement of Senator Grassley follows:]

STATEMENT OF SENATOR CHARLES E. GRASSLEY BEFORE THE COMMITTEE ON SMALL BUSINESS ON SECTION 89

MR. CHAIRMAN, I VERY MUCH APPRECIATE THE OPPORTUNITY TO PARTICIPATE IN THIS HEARING ON A SUBJECT VERY IMPORTANT TO SMALL BUSINESS AND, HENCE, VERY IMPORTANT TO MY OWN STATE OF IOWA.

FORTY-ONE PERCENT OF THOSE EMPLOYED IN IOWA ARE EMPLOYED BY FIRMS WITH FEWER THAN 49 EMPLOYEES, AND FULLY 27 PERCENT OF OUR WORKFORCE IS EMPLOYED BY FIRMS WITH FEWER THAN 19 EMPLOYEES. FURTHERMORE, IN IOWA AT THE PRESENT TIME, ABOUT 13 PERCENT OF THE STATE'S POPULATION IS WITHOUT HEALTH INSURANCE. THIS IS A POINT TO WHICH I WILL RETURN IN A MOMENT.

I HAVE RECEIVED AN OUTPOURING OF PROTEST FROM MY CONSTITUENTS ON SECTION 89. IN FACT, I HAVE SELDOM SEEN SUCH AN OUTPOURING OF DISCONTENT ON A CONGRESSIONAL ACTION. THE MAIL I RECEIVE ON THIS SUBJECT IS UNIFORMLY NEGATIVE. I DO NOT BELIEVE THAT I HAVE RECEIVED EVEN A SINGLE LETTER WHICH APPROVES OF SECTION 89.

AND IT'S EASY TO UNDERSTAND WHY IT'S NEGATIVE:

THE BURDEN OF DEMONSTRATING THAT AN EMPLOYER COMPLIES WITH SECTION 89 FALLS TO THE EMPLOYER. AND DEMONSTRATING TO THE SATISFACTION OF THE IRS THAT A BUSINESS IS IN COMPLIANCE REQUIRES COMPLEX DATA GATHERING AND ANALYSIS, THE SORT OF DATA GATHERING AND COMPUTATION IN MANY CASES BEYOND THE CAPACITY OF A SMALL BUSINESS TO PERFORM WITHOUT COSTLY OUTLAYS FOR OUTSIDE ACCOUNTING ASSISTANCE.

THE PUNITIVE ASPECTS OF THE BILL ARE ONEROUS, AND, GIVEN THAT MANY EMPLOYERS COULD REMAIN OUT OF COMPLIANCE DESPITE THEIR BEST EFFORTS TO BRING THEMSELVES INTO COMPLIANCE, UNREASONABLY SEVERE. IT IS ABSOLUTELY RIDICULOUS THAT, IN THE EVENT A PLAN IS OUT OF COMPLIANCE WITH THE QUALIFICATION STANDARDS OF SECTION 89, AN ORDINARY EMPLOYEE COULD BE TAXED ON THE VALUE OF ANY HEALTH INSURANCE PAYMENTS THEY RECEIVE.

I HAVE YET TO LEARN WHETHER WE KNOW THERE IS A PROBLEM OUT THERE IN THE ECONOMY OF A MAGNITUDE WARRANTING A STEP AS DRACONIAN AS SECTION 89. WHAT IS THE PROBLEM WE WERE TRYING TO FIX WITH THIS PROGRAM? PRHAPS THE TREASURY WITNESS WILL BE ABLE TO ENLIGHTEN US ON THIS QUESTION.

A RELATED QUESTION IS WHAT WAS THE CONSTITUENCY FOR THIS PROVISION. USUALLY ON PROBLEMS WE ADDRESS WE ARE HAVE HEARD FROM INTERESTED PARTIES CALLING OUR ATTENTION TO THE EXISTENCE OF A PROBLEM AND LAYING OUT ITS DIMENSIONS. I AM SIMPLY UNAWARE OF ANY GRAND GROUNDSWELL OF CONCERN OVER THIS QUESTION.

MR. CHAIRMAN, ONE OF THE FEARS THAT IS PRESENTLY DISCUSSED WITH RESPECT TO SECTION 89 IS THAT MANY EMPLOYERS, ESPECIALLY SMALL EMPLOYERS, WILL SIMPLY CANCEL THEIR EMPLOYEE BENEFIT PROGRAMS RATHER THAN UNDERTAKE THE COMPLEX DATA GATHERING AND TESTING PROCEDURES REQUIRED, OR RATHER THAN RUN ANY RISK OF NON-COMPLIANCE.

I DON'T KNOW WHETHER THIS IS HAPPENING OR NOT, MR. CHAIRMAN, BUT MANY OF THOSE WHO WRITE TO ME SAY THEY ARE CONSIDERING IT. IN ANY CASE, DO WE REALLY WANT TO RUN THE RISK THAT WE WILL REDUCE THE AMOUNT OF HEALTH INSURANCE AVAILABLE TO THE EMPLOYED AT A TIME WHEN WE ARE FACED WITH FROM 35 TO 37 MILLION PEOPLE IN THE COUNTRY WITHOUT HEALTH INSURANCE, MOST OF WHOM ARE EMPLOYED, AND WHEN 13 PERCENT OF THE PEOPLE OF MY STATE ARE WITHOUT HEALTH INSURANCE?

CLEARLY, THIS MONSTROSITY SHOULD BE REPEALED. I HAVE THEREFORE CO-SPONSORED SENATOR LOTT'S BILL, S. 350.

IN THE EVENT THAT THIS IS JUST NOT POSSIBLE, FOR WHATEVER REASON, SECTION 89 SHOULD BE SUBSTANTIALLY REVISED SO AS TO MAKE IT EASY TO UNDERSTAND, SIMPLE TO COMPLY WITH AND NOT RIDICULOUSLY PUNITIVE.

IF WE HAVE TO PROCEED IN THIS DIRECTION, I BELIEVE THAT SENATOR PRYOR'S BILL, S. 654, CONSTITUTES A GOOD BEGINNING, AND THEREFORE HAVE LENT MY SUPPORT TO IT ALSO.

Senator **Boschwitz**. I would ask some of the spectators if you would stand along there so that one and all can see. We should allow as many people as possible into the room. Just squeeze in over there. Try to get out of the way.

That is just fine.

Senator Dixon.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator **Dixon**. I will be very brief, Mr. Chairman, but I am delighted to yield to Senator Bond. I have another meeting, also, but I have no tremendous—mine will be very brief, Mr. Chairman.

Mr. Chairman, I applaud you for holding this hearing which will allow the Committee the opportunity to assess the impact of Section 89 as a whole and more specifically as it relates to small business concerns.

We face a situation where our goal is not attainable with the law in its present form. In addition, employers are experiencing great costs in their attempts to comply with the requirements of Section 89. The overwhelming expenses at a minimum have burdened the large corporations, but are absolutely catastrophic to small businesses.

Mr. Chairman, I am pleased to be here today, and I am anxious to hear from the distinguished panelists before us. It is essential in this process to gain insight from the practitioners and those in the business community who are directly affected by this legislation.

It is my belief that at the very least, the problems inherent in Section 89 require a postponement of its implementation. This postponement would allow time for us to closely examine Section 89 and to determine if it can be simplified and clarified or if a repeal is in order.

I thank you, Mr. Chairman, and I ask that the entirety of my remarks be reproduced in the record at this time.

Senator **Kasten** [Acting Chairman]. Without objection, so ordered.

[The prepared statement of Senator Dixon follows:]

APRIL 13, 1989

STATEMENT BY ALAN J. DIXON

COMMITTEE ON SMALL BUSINESS

OVERSIGHT HEARING ON

SECTION 89

INTERNAL REVENUE CODE

MR. CHAIRMAN, WE ARE HERE TODAY TO CONSIDER THE IMPACT OF SECTION 89 OF THE INTERNAL REVENUE CODE. I APPLAUD THE CHAIRMAN FOR HOLDING THIS HEARING WHICH WILL ALLOW THE COMMITTEE THE OPPORTUNITY TO ASSESS THE IMPACT OF SECTION 89 AS A WHOLE, AND MORE SPECIFICALLY AS IT RELATES TO SMALL BUSINESS CONCERNS.

THE CONGRESSIONAL INTENT OF SECTION 89 WAS TO ENCOURAGE EMPLOYERS TO EXPAND THEIR BENEFIT PLANS TO INCLUDE MORE LOWER-PAID AND PART-TIME EMPLOYEES. THE IMPLEMENTATION OF SECTION 89 HAS GREATLY DEVIATED FROM THIS GOAL. SECTION 89 ESTABLISHED SWEEPING CHANGES FOR EMPLOYER-PROVIDED HEALTH, ACCIDENT, AND GROUP TERM LIFE INSURANCE PLANS. THESE CHANGES GOVERNING EMPLOYEE BENEFIT PLANS HAVE NOW IMPOSED STRINGENT REQUIREMENTS UPON BUSINESSES TO PROVE THAT THEIR PLANS MEET NEW AND COMPLEX NONDISCRIMINATION AND QUALIFICATION STANDARDS.

WHAT BUSINESSES ACROSS THE NATION FACE TODAY ARE REQUIREMENTS WHICH ARE UNCLEAR, EXCESSIVELY BURDENSOME, AND COSTLY TO ADMINISTER.

THE COMPLEX TESTING PROCEDURES OF SECTION 89 HAVE CREATED AN ADMINISTRATIVE NIGHTMARE. INSTEAD OF ACTIVELY ENCOURAGING EMPLOYERS TO PROVIDE EXPANDED BENEFIT PROGRAMS, SECTION 89 HAS CAUSED MANY EMPLOYERS TO ABANDON ALTOGETHER THEIR CURRENT HEALTH PLANS, OR REQUIRE THEIR EMPLOYEES TO PAY 100 PERCENT OF THE HEALTH CARE PLANS. EVEN MORE ALARMING, EMPLOYEES THEMSELVES CAN BE SUBJECT TO SEVERE PENALTIES, IN THE FORM OF EXTRA TAXES, IF THEIR EMPLOYER'S BENEFIT PLAN FAILS TO COMPLY WITH ALL SECTION 89 QUALIFICATION REQUIREMENTS.

WE FACE A SITUATION WHERE OUR GOAL IS NOT ATTAINABLE WITH THE LAW IN ITS PRESENT FORM. IN ADDITION, EMPLOYERS ARE EXPERIENCING GREAT COSTS IN THEIR ATTEMPTS TO COMPLY WITH THE REQUIREMENTS OF SECTION 89. THE OVERWHELMING EXPENSE IS, AT A MINIMUM, A BURDEN TO LARGE CORPORATIONS, BUT ABSOLUTELY CATASTROPHIC TO SMALL BUSINESSES.

MR. CHAIRMAN, I AM PLEASED TO BE HERE TODAY, AND I'M ANXIOUS TO HEAR FROM THE DISTINGUISHED PANELISTS BEFORE US. IT IS ESSENTIAL IN THIS PROCESS TO GAIN INSIGHT FROM THE PRACTITIONERS AND THOSE IN THE BUSINESS COMMUNITY WHO ARE DIRECTLY AFFECTED BY THIS LEGISLATION. IT IS MY BELIEF, THAT AT THE VERY LEAST, THE PROBLEMS INHERENT IN SECTION 89 REQUIRE

A POSTPONEMENT OF ITS IMPLEMENTATION. THIS POSTPONEMENT WOULD ALLOW TIME FOR US TO CLOSELY EXAMINE SECTION 89, AND TO DETERMINE IF IT CAN BE SIMPLIFIED AND CLARIFIED, OR IF A REPEAL IS IN ORDER. THANK YOU, MR. CHAIRMAN.

Senator KASTEN. And the Chair would recognize the gentleman from Missouri.

STATEMENT OF HON. CHRISTOPHER S. BOND, A U.S. SENATOR FROM THE STATE OF MISSOURI

Senator BOND. Thank you, Mr. Chairman, whomever that may be. I appreciate the opportunity to make some comments. I would ask unanimous consent that my full statement be included in the record.

We are here today, Mr. Chairman, because all of our offices have been deluged with calls, with visits, with people expressing grave concern about the impact of Section 89. It is going to affect all businesses, but small businesses are going to bear a very heavy burden in order to comply with Section 89.

In addition, we have had representatives of school boards, local governments, charitable/voluntary organizations, who say they just cannot live with Section 89.

The problems with Section 89 are: No. 1, the complication of the section, No. 2, the time and the cost that will have to be expended trying to comply with it. In particular, the costs of consultants who are the only ones who have read and understood the very significant pile of regulations that go with it and, No. 3, the very real threat of severe tax penalties if you do not dot the i's and cross the t's properly.

The problems that we have heard are legion. And the results of Section 89 is not that there are going to be more equitable health care plans. So we gain nothing.

Right now we have a problem with about 37 million Americans who are not covered by health plans. Unless we do something drastic, Mr. Chairman, and I suggest outright repeal of this measure, come back and take a look at whatever the problems were that caused it, we are going to see not 37 million but 47 million or 57 million or 67 million Americans not covered by health care insurance.

And when my colleague from Iowa blamed the faceless bureaucrats for this law, I have got to cite my favorite philosopher, Walt Kelly, who said that we have met the enemy, and he is us. Congress did pass it. Nobody held a gun to our heads. I did not happen to be here when it was passed, but Congress did it, and it is up to us to undo it.

Let me just share with you some of the comments I have received. The full text of their quotes that will be included in my statement for the record, but this will give you some idea of the kind of comments we are getting.

An insurance company that provides health coverage to employers states, "This particular law has created more problems, chaos, and other areas of concern than I can remember in the 45 years I have been involved in insurance. In the last 30 days employers have indicated they were going to discontinue group health insurance."

A small manufacturer in Independence, MO said, "We have been quoted $5,000 for consulting and just testing the phase that even now is filled with ambiguities and contradictions."

An exterminating company in Kansas City said, "Estimates from various sources, it would cost us from $800 to $1,500 just to comply with the law. This may force businesses including my own simply to cancel the benefit programs."

A video store in St. Louis, "Yesterday, we received information on Section 89. For the time being we put a halt to the thought of offering any kind of health care plan. The costs, potential penalties, and recordkeeping requirements just are not worth it."

From a national bank in Columbia, MO, "Increases the cost of doing business. It discourages the expansion or continuation of fringe benefits for employees."

This official states that he is also a member of the board of two not-for-profit organizations. In both of these organizations consideration is being given to discontinuing the benefits.

From a law firm in Blue Springs, MO, "Our firm represents approximately 250 small corporations. Each and every one of them have problems, complaints, and difficulties with the infamous Section 89. Some are simply dropping all their health insurance benefits."

From the Missouri Restaurant Association, "Many employers are so bewildered, they are seriously considering discontinuing paid health and life insurance benefits for their employees. This is contrary to the efforts to provide adequate health insurance for American citizens. Congress should focus its efforts on making health insurance more affordable, not more costly, cumbersome, and difficult to administer."

Mr. Chairman, these are only a small sample of the comments we are getting. I am confident that every one of us, every Member of the Senate, every Member of the House probably has similar comments and complaints coming in.

I thank you very much for calling this hearing. I hope that this Committee can provide the impetus necessary along with the resolutions we passed yesterday on the Floor to get something moving before we force a significant number of employers to drop health care plans and leave a much larger percentage of our population uncovered by health insurance. Thank you, Mr. Chairman.

[The prepared statement of Senator Bond follows:]

STATEMENT OF SENATOR BOND

MR. CHAIRMAN, I COMMEND YOU AND THE RANKING MEMBER MR. BOSCHWITZ FOR SCHEDULING THIS HEARING TODAY. I BELIEVE IT IS VERY APPROPRIATE THAT THIS HEARING, IS BEING HELD IN THE SMALL BUSINESS COMMITTEE. WHILE SECTION 89 OF THE INTERNAL REVENUE CODE OF 1986 WILL HAVE A GRAVE IMPACT ON BUSINESSES OF ALL SIZES, IT IS THE SMALL BUSINESS COMMUNITY AND ITS EMPLOYEES WHO WILL PAY THE GREATEST PRICE IN LOST PRODUCTION, LOST PROFITS, AND LOST HEALTH BENEFITS.

OVER THE PAST SEVERAL MONTHS, HUNDREDS OF SMALL BUSINESS OWNERS HAVE WRITTEN AND CALLED MY OFFICE TO EXPRESS THEIR OPPOSITION TO SECTION 89, PARTICULARLY AS IT APPLIES TO HEALTH BENEFIT PLANS. SEVERAL PROBLEMS OF MAJOR CONCERN ARE CAUSING THE SMALL BUSINESS OWNERS OF MISSOURI TO CRY OUT FOR RELIEF:

1) THE COMPLICATION OF THE SECTION,
2) THE TIME THAT WILL HAVE TO BE EXPENDED TRYING TO UNDERSTAND IT,
3) THE HIGH COST OF CONSULTANTS TO INSURE THAT PLANS ARE NONDISCRIMINATORY, AND
4) THE THREAT OF SEVERE TAX PENALTIES.

THE MAJORITY OF SMALL BUSINESS OWNERS WHO HAVE CONTACTED ME, OFFER THE BEST HEALTH PLAN THEY CAN AFFORD TO THEIR EMPLOYEES AND THEY DO NOT UNDERSTAND WHY THEY ARE BEING PENALIZED FOR TRYING TO BE RESPONSIBLE EMPLOYERS.

WHILE THIS LEGISLATION MIGHT HAVE BEEN ENACTED WITH GOOD INTENTIONS, THE RESULT TO MISSOURI EMPLOYERS AND EMPLOYEES MAY BE CATASTROPHIC. SOME EMPLOYERS ARE DROPPING, OR ARE CONSIDERING DROPPING, THEIR PLANS. INSTEAD OF OFFERING GROUP PLANS, EMPLOYERS MAY ELECT TO PAY THE MONETARY VALUE OF THE POLICY DIRECTLY TO EMPLOYEES, THE RESULT OF WHICH WILL BE THAT MANY EMPLOYEES WILL NOT SPEND THE MONEY ON HEALTH COVERAGE, WILL NOT BE ABLE TO GET COVERAGE ON THEIR OWN DUE TO EXISTING HEALTH PROBLEMS, OR WILL ONLY BE ABLE TO GET COVERAGE AT A GREATLY INCREASED PRICE.

TODAY, I WOULD LIKE TO SHARE SOME OF THE COMMENTS I HAVE RECEIVED FROM BUSINESSES IN MISSOURI:

FROM WILSON-TURNER-GAVIN, INC, AN INSURANCE COMPANY IN JOPLIN, MO:

> THIS PARTICULAR LAW HAS CREATED MORE PROBLEMS, CHAOS, AND OTHER AREAS OF CONCERN THAN ANY I CAN REMEMBER IN 45 YEARS. I HAVE BEEN INVOLVED IN INSURANCE...FOR OVER 30 YEARS; AND I HAVE NEVER SEEN SO MUCH UNREST AS THIS...ON MANY OCCASIONS IN THE LAST 30 DAYS, EMPLOYERS HAVE INDICATED THEY WERE GOING TO DISCONTINUE THE GROUP HEALTH INSURANCE AND GIVE THE MONEY TO THE EMPLOYEES, AND LET HIM SEEK HIS OWN COVERAGE.

FROM GEO. C. MATTESON CO., INC, A MANUFACTURER IN INDEPENDENCE, MO:

> FOR THE SMALL BUSINESSMAN LIKE MYSELF, IT HAS BECOME A VIRTUAL NIGHTMARE...IT PLACES AN ECONOMIC AND ADMINISTRATIVE BURDEN ON THE SMALL EMPLOYER FAR OUT OF PROPORTION, IN MY VIEW, TO THE BENEFITS DERIVED...WE HAVE BEEN QUOTED $5,000 FOR CONSULTING

IN JUST THE "TESTING" PHASE THAT EVEN NOW IS FILLED WITH AMBIGUITIES AND CONTRADICTIONS.

FROM GUNTER EXTERMINATING CO. IN KANSAS CITY, MO:

WE HAVE ALWAYS TRIED TO OFFER BENEFITS TO OUR EMPLOYEES ON A FAIR AND EQUITABLE BASIS, BUT TO PASS THE TESTS REQUIRED BY "SECTION 89" WILL PLACE A REAL BURDEN ON US. I HAVE HAD ESTIMATES FROM VARIOUS SOURCES THAT IT COULD COST US FROM $800 TO $1500 JUST TO COMPLY WITH THE LAW!...THIS MAY FORCE MANY BUSINESSES, INCLUDING MY OWN, TO SIMPLY CANCEL ALL EMPLOYEE BENEFIT PROGRAMS...

FROM PLAZA VIDEO IN ST. LOUIS, MO:

FOR THE LAST FEW WEEKS WE HAVE BEEN MULLING OVER VARIOUS BENEFIT PLANS, TRYING TO DECIDE WHICH TO MAKE AVAILABLE TO OUR EMPLOYEES AS A NEW BENEFIT. YESTERDAY, WE RECEIVED INFORMATION ON SECTION 89 OF THE INTERNAL REVENUE CODE AND FOR THE TIME BEING HAVE PUT A HALT TO THE THOUGHT OF OFFERING ANY KIND OF PLAN. THE COSTS, POTENTIAL PENALTIES AND RECORD KEEPING REQUIREMENTS AREN'T WORTH IT!

FROM BOONE COUNTY NATIONAL BANK IN COLUMBIA, MO:

...IT INCREASES THE COST OF DOING BUSINESS, DISCOURAGES THE EXPANSION OR CONTINUANCE OF FRINGE BENEFITS FOR EMPLOYEES, AND IS A HIDDEN WAY OF RAISING TAXES FOR THE FEDERAL GOVERNMENT... I AM ALSO A MEMBER OF THE BOARD OF DIRECTORS OF TWO NON-PROFIT ORGANIZATIONS -- THE VISITING NURSES ASSOCIATION OF CENTRAL

MISSOURI, AND THE COLUMBIA AREA UNITED WAY. IN BOTH OF THESE ORGANIZATIONS, CONSIDERATION IS BEING GIVEN TO DISCONTINUING BENEFITS AND ADDING THE COST OF THOSE BENEFITS TO THE SALARIES OF EMPLOYEES IN LIEU OF BENEFITS.

FROM COCHRAN, OSWALD, BARTON, MCDONALD & GRAHAN, LAW OFFICES IN BLUE SPRINGS, MO:

OUR FIRM REPRESENTS APPROXIMATELY 250 SMALL CORPORATIONS... TO THE LETTER EACH AND EVERY ONE OF THEM HAVE PROBLEMS, COMPLAINTS AND DIFFICULTIES WITH THE INFAMOUS SECTION 89.... SOME ARE SIMPLY DROPPING ALL THEIR HEALTH INSURANCE BENEFITS AND, FOR THAT MATTER, SOME OTHER IMPORTANT BENEFITS TO THEMSELVES, THEIR EMPLOYEES AND THEIR FAMILIES, ALONG WITH IT.

FROM THE MISSOURI RESTAURANT ASSOCIATION:

MANY EMPLOYERS ARE SO BEWILDERED THAT THEY ARE SERIOUSLY CONSIDERING DISCONTINUING PAID HEALTH AND LIFE INSURANCE BENEFITS FOR THEIR EMPLOYEES. OBVIOUSLY, THIS WOULD PLAY INTO THE HANDS OF EFFORTS TO INCREASE TAX REVENUES, BUT THIS IS CONTRARY TO EFFORTS TO PROVIDE ADEQUATE HEALTH INSURANCE FOR AMERICAN CITIZENS...CONGRESS SHOULD FOCUS ITS EFFORTS ON MAKING HEALTH INSURANCE MORE AFFORDABLE, NOT MORE COSTLY, CUMBERSOME, AND DIFFICULT TO ADMINISTER.

FROM BEUSSINK, HEY, MARTIN, NAILE & ROE, CERTIFIED PUBLIC ACCOUNTANTS IN CAPE GIRARDEAU, MO:

> IN MY PROFESSIONAL JUDGEMENT, IRC SECTION 89 IS POOR TAX POLICY AND POOR SOCIAL POLICY. THIS STATUTE IS UNWORKABLE FROM A TECHNICAL AND COMPLIANCE STANDPOINT, AND IS SO POTENTIALLY PUNITIVE THAT MANY EMPLOYERS WILL CHOOSE TO SIMPLY REDUCE OR ELIMINATE ESSENTIAL EMPLOYEE BENEFITS SUCH AS HEALTH INSURANCE RATHER THAN FACE THE HIGH COSTS OF COMPLIANCE AND CONTINUOUS EXPOSURE TO SUBSTANTIAL IRS PENALTIES.

AND FINALLY, FROM GASKET & SEAL FABRICATORS,INC. IN ST. LOUIS, MO:

> WE HAVE ALWAYS FELT IT OUR OBLIGATION TO PROVIDE HEALTH INSURANCE AT NO COST TO OUR EMPLOYEES, PAY HIGHER WAGES THAN OUR COMPETITORS AND QUITE SIMPLY TREAT OUR EMPLOYEES AS WE WOULD WISH TO BE TREATED OURSELVES. HOWEVER, SECTION 89 PAPERWORK REQUIREMENTS NOW MAKE ME WONDER WHY WE EVER PROVIDED ANY BENEFITS. PLEASE CORRECT THIS GROSS ERROR.

THESE AND SIMILAR COMMENTS FROM ALL OVER MISSOURI HAVE CONVINCED ME THAT SECTION 89 MUST BE REPEALED. REVISION AND SIMPLIFICATION IS NOT GOOD ENOUGH. I HAVE HEARD THE COMMENTS OF SOME MEMBERS OF CONGRESS WHO BELIEVE THAT THE SECTION SHOULD GRADUALLY BE MODIFIED UNTIL ALL THE BUGS ARE IRONED OUT, BUT THIS WILL ONLY LEAVE EMPLOYERS MORE ANXIOUS THAN THEY ARE NOW ABOUT WHAT CHANGES WILL OCCUR IN THE FUTURE AND WHETHER OR NOT THEY WILL STILL BE IN COMPLIANCE. CONTINUAL REVISION OF THE SECTION WILL COST EMPLOYERS EVEN MORE MONEY FOR CONSULTANTS AND WILL CAUSE MORE EMPLOYERS TO DROP EXISTING COVERAGE.

ACCORDING TO ITS SUPPORTERS, THE ORIGINAL INTENT OF SECTION 89, IS TO ENCOURAGE MORE EMPLOYERS TO PROVIDE NONDISCRIMINATORY BENEFITS TO ALL THEIR EMPLOYEES. OBVIOUSLY, IT IS NOT GOING TO PRODUCE THAT EFFECT. INSTEAD, IT IS GOING TO COST EMPLOYERS A GREAT DEAL OF TIME AND MONEY, IT WILL REDUCE THE AMOUNT OF BENEFITS OFFERED, AND IT WILL DISCOURAGE EMPLOYERS FROM OFFERING BENEFITS IN THE FUTURE. EVEN WORSE, IT IS PUNISHING EMPLOYERS WHO ARE ALREADY OFFERING NONDISCRIMINATORY BENEFITS TO THEIR EMPLOYEES, BY WASTING THEIR TIME AND MONEY TO PROVE THEY DO NOT DISCRIMINATE. THIS EFFORT COULD BE BETTER SPENT IN IMPROVING THEIR BUSINESSES, THEREBY IMPROVING THE ECONOMY OF MISSOURI AND OF THE NATION.

I AM VERY PLEASED THAT THERE ARE ENOUGH COSPONSORS ON H.R. 634, THAT, IF A VOTE WERE TAKEN TODAY, THE HOUSE WOULD VOTE TO REPEAL SECTION 89. IT IS UNFORTUNATE THAT THE SAME CANNOT BE SAID FOR S. 350. I HOPE, HOWEVER, THAT THIS HEARING WILL CONVINCE OTHER MEMBERS OF THE SENATE THAT THIS UNTENABLE SECTION OF THE INTERNAL REVENUE CODE MUST BE REPEALED.

Senator **Boschwitz**. I thank the Senator from Missouri. And now that you are here, I trust that no more legislation of this type will slip through the Congress.

Senator **Bond**. Mr. Chairman, having just completed the markup of the savings and loan bill in banking yesterday, I can almost assure you that there are some glitches in there somewhere, but perhaps with your sharp eye we will be able to identify them when they get to the Floor.

Senator **Boschwitz**. Well, the Senator from Illinois and I noted that—did you notice that?

Senator **Bond**. I did not have room to bring along my little washbowl to wash my hands in it, Mr. Chairman.

Senator **Boschwitz**. The Senator from Illinois.

Senator **Dixon**. I made my statement, I think, Mr. Chairman.

Senator **Boschwitz**. Oh, in my absence. Fine.

The Senator from Montana.

STATEMENT OF HON. CONRAD BURNS, A U.S. SENATOR FROM THE STATE OF MONTANA

Senator **Burns**. Thank you, Mr. Chairman. Again, I want to thank you for calling these hearings. I do not think there has been anything through our office that has created more mail—other than the catastrophic health insurance—than this business of Section 89.

We nearly passed an amendment yesterday offered by Senator Kasten to delay the implementation of Section 89. So, it is obvious that the Members of Congress are ready to act on this thing issue to put it to bed. I also think it is pretty obvious that small business in America is also ready for us to act, too.

In our State of Montana, two out of every three jobs are small business. In other words, over 90 percent of our businesses in Montana employ less than 20 people, and it is particularly hard on these small businesses to survive under this kind of legislation.

I want to thank Senator Grassley. I think he hit the nail right on the head. I ask unanimous consent that my remarks be entered into the record, and we can get on with the hearing. I am afraid it is going to be apple picking time before we hear from Senator Symms.

Senator **Boschwitz**. I believe he is in that business, too, so he may have to get back and pick them.

By unanimous consent, your entire statement will be put in the record, and we turn to the Senator from Mississippi, who is leading the charge here to repeal Section 89, and I understand has quite a formidable list of co-sponsors to his legislation.

[The prepared statement of Senator Burns follows:]

SENATOR CONRAD BURNS

SMALL BUSINESS COMMITTEE

ON SECTION 89

APRIL 13, 1989

THANK YOU, MR. CHAIRMAN, AND I WANT TO THANK YOU FOR AGREEING TO HOLD THIS HEARING. AS YOU KNOW, WE VOTED ON A RESOLUTION YESTERDAY WHICH URGES THE HOUSE TO ACT ON THIS MATTER. WE ALSO NEARLY PASSED AN AMENDMENT OFFERED BY SENATOR KASTEN TO DELAY THE IMPLEMENTATION OF SECTION 89. IT IS OBVIOUS THAT THE MEMBERS OF THIS COMMITTEE AND THE MEMBERS OF THE FULL SENATE ARE READY TO ACT.

IT IS ALSO OBVIOUS THAT SMALL BUSINESSES ACROSS AMERICA ARE READY FOR US TO ACT. PRACTICALLY EVERYONE WHO WALKS THROUGH THE DOOR OF MY OFFICE MENTIONS SECTION 89 OR AT LEAST IT SEEMS SO. I WAS MEETING WITH MONTANA REPRESENTATIVES OF THE AMERICAN ASSOCIATION OF HOMES FOR THE AGING THE OTHER DAY, AND THEY MENTIONED THE BURDEN THAT SECTION 89 IS PLACING ON THEM. THE PRESIDENT OF BLUE CROSS/BLUE SHIELD OF MONTANA, A MAJOR HEALTH INSURANCE PROVIDER AND THE ADMINISTRATOR OF MEDICARE IN MONTANA, TOLD ME THAT IT WILL PROBABLY COST THEM $12,000 A YEAR JUST TO TEST THEIR PLANS. THEY WILL PROBABLY HAVE TO HIRE A STAFF PERSON JUST TO COMPLY WITH SECTION 89. IT IS MY OPINION THAT THE BURDEN THAT SECTION 89 PLACES ON SMALL BUSINESSES MUST BE ELIMINATED. THESE BUSINESSES CANNOT AFFORD TO SPEND $100 OR $200, OR $1,000, A YEAR JUST TO PROVE THAT THEY ARE COMPLYING WITH THIS LAW.

WE HAVE HEARD MANY TIMES THAT, RATHER THAN COMPLYING WITH SECTION 89, SMALL BUSINESSES MAY OPT TO DROP THEIR BENEFITS PLANS. WELL, I RECENTLY SPOKE WITH A C.P.A. FIRM IN MONTANA AND FOUND OUT THAT IS EXACTLY WHAT IS HAPPENING. A REPRESENTATIVE OF THE FIRM TOLD ME 5 OF THEIR CLIENTS HAVE ALREADY DECIDED TO DROP THEIR BENEFITS PLANS IN ORDER TO AVOID COSTLY COMPLIANCE WITH SECTION 89. HE SAID THAT ABOUT 200 OTHER BUSINESSES HAVE CONTACTED THEM AND MANY OF THEM ARE CONSIDERING TAKING THE SAME ACTION, BUT THEY ARE WAITING TO SEE IF THEIR WARNINGS WILL BE HEEDED OUT HERE.

IT WAS AFTER LEARNING THIS INFORMATION THAT I DECIDED TO SUPPORT REPEAL OF SECTION 89. I HAVE NO ARGUMENT WITH THE ORIGINAL INTENT OF SECTION 89 AND BELIEVE THAT EMPLOYER-PROVIDED BENEFIT PLANS SHOULD NOT DISCRIMINATE AGAINST THE "RANK-AND-FILE" WORKER. HOWEVER, IF EMPLOYERS ARE GOING TO START DROPPING THEIR PLANS IN ORDER TO AVOID THIS ADDITIONAL COST THAT THEY CAN'T AFFORD, THEN EMPLOYEES ARE GOING TO BE WORSE OFF THAN THEY WERE BEFORE.

I LOOK FORWARD TO HEARING THE TESTIMONY OF THE WITNESSES, AND ESPECIALLY TO HEARING FROM THE DEPARTMENT OF TREASURY ON THIS ISSUE. I HOPE THAT WE CAN REACH SOME AGREEMENT AS TO WHAT ACTION TO TAKE, AND THAT WE CAN MOVE QUICKLY TO RELIEVE SMALL BUSINESSES OF THE BURDEN PLACED ON THEM BY SECTION 89.

STATEMENT OF HON. TRENT LOTT, A U.S. SENATOR FROM THE STATE OF MISSISSIPPI

Senator LOTT. I do, Mr. Chairman, and I, too, will be brief because I want to hear from our colleague, here, Steve Symms from Idaho on this matter, and I want to commend the Chairman for his leadership and initiative in this area in having this hearing. And I must say I am very impressed by the bipartisan interest in sponsorship and participation that I have seen both yesterday on the Floor of the Senate and today in this hearing just by the turnout. It is very impressive at a Small Business Committee hearing like this.

It is also refreshing to me to hear the Senators from around the country point out the specifics, proving once again that all politics and hopefully Government is local with examples we have heard from Iowa, Montana, and Missouri and all around this country, we are hearing what legislation this particular case Section 89 is doing to the real world, the small businessmen and businesswomen across this country. So, I feel very good about what I see happening here.

Now, I want to emphasize in my mind we should repeal this section. We can tamper with it, we can change it, we can mess around with it, we can start excluding or exempting groups, and that really gives me trouble because which ones do you choose to exclude or exempt and which ones do you leave in the pot. It is a mess, and I am afraid the more we tamper with it, the messier it is going to get.

So, while delays are fine and modifications are fine, perhaps I think that the only solution here is to repeal it. And as we get into it, as we hear this testimony, I think more and more of us are going to come to that conclusion.

In that vein I would like to point out that we now have some 300 sponsors in the House of Representatives to repeal Section 89 and that now we have, I would like to announce this morning, through the assistance once again and leadership of Senator Boschwitz, we are adding 13 new sponsors to S. 350 to go with 17 that we already had. And I would like to read those: Senator Burns, Senator Breaux, Senator Boschwitz, Senator Gorton, Senator McCain, Senator Boren, Senator Grassley, Senator Garn, Senator Stevens, Senator Gramm of Texas, Senator Hatch, Senator Rudman, and Senator Thurmond are joining, bringing to a total 30 Senators now on the bill to repeal Section 89.

I am very anxious to hear the witnesses this morning, so I will not go on further. I would like, though, to make sure that there is the local touch of my own State, and I ask consent, Mr. Chairman, to include some questions and some expressions of concern by at least one small business firm I have in Mississippi, and I have these questions I would like to put in the record and also questions and suggestions from the Jackson, MS Public School District.

And with that, I yield my time and look forward to hearing Senator Symms.

Senator BOSCHWITZ. Those things will be entered in the record without objection, Senator.

[Information follows:]

TO: SENATOR LOTT
FR: JACKSON PUBLIC SCHOOL DISTRICT
DT: APRIL 7, 1989
RE: SECTION 89

PLEASE CONSIDER OUR VIEWS TO THE FOLLOWING QUESTIONS:

1. HOW WILL IT AFFECT YOUR COMPANY, YOUR EMPLOYEES?

SECTION 89 WILL AFFECT THE EMPLOYEES OF JACKSON PUBLIC SCHOOLS BY LOWERING THE BENEFITS OF THE CERTIFIED PERSONNEL IN ORDER TO EQUALIZE THE BENEFITS OF THE CLASSIFIED PERSONNEL.
(CERTIFIED PERSONNEL = CLASSROOM TEACHERS)
(CLASSIFIED PERSONNEL = AIDES, CUSTODIANS, ETC)

2. WHAT COSTS HAVE ALREADY BEEN INCURRED ? WHAT DO YOU ANTICIPATE IT TO COST YOUR COMPANY, YOUR EMPLOYEES?

MAN HOURS USED IN RUNNING THE TEST AND NOTIFYING THE HIGHLY COMPENSATED EMPLOYEES OF THEIR BENEFIT REDUCTION AND WHAT WILL BE ALLOWED THROUGH THE SECTION 125 PLAN WHICH IS IN EFFECT FOR THE EMPLOYEES OF THE SCHOOL DISTRICT. J.P.S. DOES NOT PROVIDE BENEFITS FOR ITS EMPLOYEES. HOWEVER, WE DO OFFER A SECTION 125 C CAFETERIA PLAN WHICH THE EMPLOYEES USE TO RUN THEIR BENEFITS WHICH THEY PAY FOR THROUGH. IT IS MY UNDERSTANDING THAT BECAUSE THE SCHOOL DISTRICT OFFERS THIS CAFETERIA PLAN VEHICLE WE MUST COMPLY WITH SECTION 89.

3. WHY IS REPEAL THE BEST MOVE?

IT SHOULD BE REPEALED BECAUSE OF THE BURDEN IT WILL PLACE ON THE EMPLOYER IN TERMS OF MAN HOURS AND DOLLARS.

4. ARE WE BEING DISCRIMINATORY IN THE BENEFITS WE OFFER? IF SO, EXPLAIN?

NO! ALL EMPLOYEES OF J.P.S. ARE OFFERED THE SAME BENEFITS.

5. WHY IS NOT IN THE BEST INTEREST OF OUR EMPLOYEES TO MANDATE IDENTICAL EMPLOYEE BENEFITS?

UNAFFORDABLE. THERE IS A DECLINE IN THE NUMBER OF TEACHERS AVAILABLE FOR THE CLASSROOM, EVERY EXTRA DOLLAR SHOULD BE SPENT ON MAKING THE JOB OF CLASSROOM TEACHER MORE ATTRACTIVE.

6. IF REPEAL APPEARS TO BE UNACCEPTABLE TO CONGRESS, WHAT CHANGES WOULD YOU SUGGEST? EXEMPT PUBLIC SCHOOL DISTRICTS.

TO: SENATOR LOTT
FR: IRBY CONSTRUCTION COMPANY, JACKSON, MISSISSIPPI
DT: APRIL 7, 1989
RE: SECTION 89

PLEASE CONSIDER OUR VIEWS TO THE FOLLOWING QUESTIONS:

1. HOW WILL IT AFFECT YOUR COMPANY, YOUR EMPLOYEES?
INCREASED ADMINISTRATIVE BURDEN TO TEST PLANS FOR NONDISCRIMINATION. ADDITIONAL COST OF COMPUTER SOFTWARE TO ACCUMULATE DATA AND COST TO HAVE DATA TESTED. POTENTIAL INCREASE IN PREMIUMS TO EMPLOYEES IF IDENTICAL BENEFITS ARE MANDATED.

2. WHAT COSTS HAVE ALREADY BEEN INCURRED ? WHAT DO YOU ANTICIPATE IT TO COST YOUR COMPANY, YOUR EMPLOYEES?

COMPUTER SOFTWARE TO ACCUMULATE DATA. $800.00
COST TO HAVE DATA TESTED. NO ESTIMATE OF FEE AT THIS TIME.
COST OF ONE ADDITIONAL EMPLOYEE FOR RECORD KEEPING.

3. WHY IS REPEAL THE BEST MOVE?
BASED UPON OUR KNOWLEDGE OF SECTION 89 AT THIS TIME, IT APPEARS TO US THAT THE SECTION HAS THE POTENTIAL TO ADVERSELY EFFECT THE AVERAGE EMPLOYEE MORE THAN HELP.

4. ARE WE BEING DISCRIMINATORY IN THE BENEFITS WE OFFER? IF SO, EXPLAIN?
HEALTH INSURANCE IS OFFERED TO ALL EMPLOYEES ON THE SAME BASIS. THE COMPANY PAYS THE COST OF EMPLOYEE COVERAGE. EMPLOYEES MAY ELECT TO COVER SPOUSE AND DEPENDANTS FOR AN ADDITIONAL PREMIUM WHICH THE EMPLOYEE PAYS.

5. WHY IS NOT IN THE BEST INTEREST OF OUR EMPLOYEES TO MANDATE IDENTICAL EMPLOYEE BENEFITS?
IF ONLY ONE OPTION IS AVAILABLE FOR HEALTH COVERAGE, LOGICALLY IT WOULD HAVE TO BE FAMILY COVERAGE RESULTING IN THE SAME PREMIUM FOR ALL EMPLOYEES. WHO WILL PAY THE ADDITIONAL COST FOR EMPLOYEES NOW ELECTING ONLY EMPLOYEE COVERAGE WHICH THE COMPANY PAYS? WILL THE EMPLOYEE OR COMPANY BEAR THIS COST? THE COMPANY COULD ELECT TO DISCONTINUE HEALTH COVERAGE RATHER THAN TO BEAR THE ADDITIONAL COST.

6. IF REPEAL APPEARS TO BE UNACCEPTABLE TO CONGRESS, WHAT CHANGES WOULD YOU SUGGEST?
IF ANY EMPLOYEE IS REQUIRED TO INCLUDE THE VALUE OF A HEALTH CLAIM IN INCOME, ASSUMING THAT A PLAN IS DISCRIMINATORY, THE RESULT WOULD BE DEVASTATING TO THE INDIVIDUAL IF THE CLAIM IS FOR A MAJOR ILLNESS.

Senator BOSCHWITZ. We now turn to our friend from the State of Idaho.

STATEMENT OF HON. STEVE SYMMS, A U.S. SENATOR FROM THE STATE OF IDAHO

Senator SYMMS. Thank you very much, Mr. Chairman, and Members of the Committee. I appreciate the opportunity to be here among people who are all my friends in this Committee, and I am happy to see that we seem to have such a meeting of the minds, and we are going to accomplish this.

Senator Boschwitz, you mentioned that I am in the apple business, which is quite correct, and it is one of my guiding principles to guide me here in Washington that I learned at a very young age that someone has to grow an apple before someone else can divide it up.

And the people in Washington, DC are generally in the business of dividing up production and not helping people produce it. And I think that this is a classic example.

I truly appreciated Senator Grassley's remarks about the fact that this came from somewhere in the bureaucracy. Look at the size of this handbook that Senator Boschwitz showed and think about our small business people having to comply with this. It is absolutely outrageous, and where it came from—it is regurgitated up out of the bowels of the Treasury is exactly where it comes from. There is no other way to do it.

I would urge all of you to do what I did yesterday. It just happened as a coincidence, but our former colleague and friend, Secretary of the Treasury Brady was on the Floor yesterday, and I appealed to him. I said look what is happening on these votes.

The Kasten bill gets 56 votes in favor of it against parliamentary procedures. If we would have had an up or down vote on it, the Kasten bill would have passed yesterday. The Lott bill to repeal it and my own bill—the sense of the Senate, the combination of those two got a 98 to nothing vote. So, I appealed to Secretary Brady, and I think all of you should urge the Treasury to do this, to issue an Executive order, and I believe, Mr. Chairman that they have the authority to do this, to put the word out across the country from Treasury by press release, for IRS to stop this kind of nonsense with this big compliance book and just say that Congress obviously is going to act on this to cease and desist any further activity on Section 89 until Congress acts on it.

This is another instance where our colleague from Wisconsin was so able 3 years ago or 5 years ago in stopping the ridiculous idea to withhold taxes from dividends and interest where the American people have got their back up. They do not want this. And they should not have it shoved down their throats by people inside the Beltway in Washington in a faceless bureaucracy as Senator Grassley was speaking of. And I think we are going to win this issue.

So, I really thank Chairman Boschwitz for his interest and efforts on it. He is a businessman. He understands the problem. You all understand the problem, and I want to just make a couple of comments, and I would ask unanimous consent, Mr. Chairman, that my entire statement be a part of the record, and I will briefly hit a couple of highlights.

Senator BOSCHWITZ. Without objection.

Senator SYMMS. I just want to say that the one comment that I thought was so great was Tom Veal of Touch Ross & Company. He summarized this entire nightmare when he claimed that if King George and Parliament had come up with anything like Section 89, that it would not have taken General Washington 7 years to have won the Revolutionary War. It would have happened much faster. And I think we have reached that point.

And if we cannot repeal something as obnoxious as this, well, then, we all ought to turn in our Senate cards and go back to our respective States and seek some other pursuit. And I think that we are on the right track. We have got the votes to do it. IRS needs to back off of the matter, and the reason that I say that it is so important is forgetting the business owners themselves, the people who work for these companies, if they lose these plans, it is devastating.

Take, for instance, the case of a person who is on some kind of a health plan in a small company and they have a child, let us say, that happens to have cerebral palsy. What happens if their company cancels the plan? These are real people we are talking about that are going to be punished. They will not be able to go buy private insurance in many cases if they have a predetermined illness in the family that is of a terminal or chronic nature.

So, we are talking about the lives of working people in every State in the union. It is exactly as Senator Kasten said and Senator Lott. It is not regional. It affects every single person across this country. It affects the health delivery system. It affects the lives of the people that are now under plans that may be excluded from those plans and then will not be able to get private insurance. It is going exactly the opposite of what was intended, and I personally think that there is nothing wrong with saying look, it was a mistake. It got put in a big bill. Let us just repeal it and take it out.

And I want to say again, Senator Boren and I were on the Finance Committee at that time. Dwight Ripley, who for many years was a private CPA in Napa, ID, came back and worked for me during the period during the 2-year period when the Tax Reform Act passed, and he offered a great deal of insight and wisdom to many of our young staff people on the Committee. And he had a statement that he used to tell me. He would say, "Steve, if you people in Congress could just fix the Tax Code as easy as you foul it up, as fast, this tax reform bill could be corrected to make it into a very positive thing that happened to the American people. But you have to go back now and clean it up."

This is the first step, and I think that we will get it done, and I welcome all the support, and I thank Senator Lott for his leadership, Senator Kasten for his courage yesterday to force this issue to a vote that really had teeth in it. We welcome the support, the bipartisan support that we are getting, and I think that we can accomplish this. It will save thousands and thousands of dollars.

I will just make one other comment, Mr. Chairman, on the question of what it costs. We, in the Finance Committee, end up constantly having to defend what something is going to cost to comply with the budget rule. And my view of this is I do not know how we are ever going to get control of it, but we have to exert our influence and our power on this issue and take senatorial privilege over the staff rule-writing in the Senate and make it very clear if it is going to cost a billion dollars to comply with this regulation—and I think that is probably a conservative estimate—at a 34 percent tax rate with most of these companies paying that, that is $340 million of lost revenue to the U.S. Treasury that would be in the profit column that will now be in the expense column and it is a tax deductible item to pay accountants and lawyers and other people to try to figure these things out.

So, that completely repudiates the argument of Senator Grassley's faceless number cruncher that he makes the point that somehow somebody comes up with these ideas that will make $150 million or so much or $200 million for the Treasury and get this fairness and equity out there.

And I think that we just simply have to do this. So, I really thank this Committee. I thank my colleagues who have worked so hard on this issue, and I think together we must get this done, and the sooner, the better.

And I would urge all of you, as I did yesterday, to call the Secretary of the Treasury and let us get the Treasury Department to get a statement out so that the American people know that they are not going to be harassed. Otherwise, I think the American people one of these days when they wake up to what goes on in this town, they are going to come in and start dumping tea in the Potomac River, and they have every reason to do it. And I welcome them. Thank you very much, Mr. Chairman.

[The prepared statement of Senator Symms follows:]

BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS

Statement of Steve Symms

Senator from Idaho

April 13, 1989

Mr. Chairman, I am pleased to be able to testify today before the Senate Committee on Small Business. The vote of 98 to 0 in the Senate yesterday on my amendment to urge the House of Representatives immediately to send us a bill to repeal or modify substantially Section 89 of the tax code was a great victory for all of us. I think the Senate has spoken so loudly and clearly that we will get action on this problem very shortly.

Having reviewed various material regarding Section 89 and having been part of a growing effort to delay or repeal this administrative nightmare, I am increasingly convinced that Congress stepped off into the deep end of an enormous bureaucratic swamp when it adopted this portion of the 1986 Tax Reform Act.

In short, my testimony today will attempt to shed some light on the quagmire that exists for small businesses attempting to comply with several provisions that affect employee benefits.

Section 89 establishes highly complex, new requirements for the tax exemption of employee benefits, all employee benefits. Under this new provision, employers must now calculate "values" to learn whether their benefits qualify for tax exemption. So encompassing is this new regulation, employee benefits will now have to be painstakingly analyzed to determine if they are divided fairly between highly paid employees and rank-and-file workers. This doesn't even taken into consideration that now part-time employees must be included in calculations to determine whether plans are discriminatory.

This entire testing process is so boggling that many employers are writing and informing me that they plan to drop employee benefit programs outright, due to the unreal complexity and extensive costs associated with this monster. I think Thomas Veal of Touche Ross and Co. best summarized this entire regulation when he claimed that if King George and Parliament had come up with anything like Section 89, it wouldn't have taken seven years to win the Revolutionary War. Quite frankly, Section 89 nearly approaches the dangerous and certainly anti-free market policy of Federally mandated, employer-provided benefits.

To make matters worse, the Federal government expects businesses to navigate through this mine filled sea when its own Internal Revenue Service is still unable to come up with a complete set of guidelines to augment exisiting law. To date, the I.R.S. has had over two and a half years since the passage of the 1986 Tax Reform Act. To be certain, I'm beginning to wonder if the I.R.S. will be able to implement operating procedures to an extent that the one year delay I've proposed in my bill, S.89, will be long enough.

I also wish to point out the costs associated with this section of the tax code. Few argue the fact that compliance with these regulations will cost businesses thousands of dollars. The end result will be that cost-conscious business will take a position of either dropping plans or accepting the penalties associated with non-compliance based strictly on cost.

Nearly all employers attempt to offer some sort of an employee benefit program; it simply is good business to reward employees. It seems incredibly ironic to me that representatives of United States citizens that claim to be fighting for the little guy would back a proposal that virtually strips employee benefits from those most in need of such programs. It's not as though employee benefit programs are elitist in nature. It is estimated that some 132 million people in the United States receive employer-provided benefits either as employees or dependents. This is elitism?

And then of course there are the supporters of Section 89 who claim budget deficit rules preclude a vote on this issue. The Joint Tax Committee has claimed that if employers abandon fringe benefit and pension plans because of Section 89, the added tax revenue to the Treasury will be $300 million in 1989 alone. Thus, if we repeal or delay it for one year, we supposedly have to come up with a "revenue offset" or a spending cut of $300 million under the rules of the Budget Act.

This phony revenue estimate is ludicrous, because the costs of compliance with Section 89 -- for all employers -- will exceed a billion dollars. At a marginal tax rate of 34 percent, that cost of doing business will lose $340 million to the Federal Treasury. I claim that repealing Section 89 really won't cost the Federal Treasury any revenue; it certainly will make American business more productive. I love my CPAs and benefit managers back in Idaho, but I would certainly prefer to let all the money that is going to have to be paid to test and re-test these benefit plans be applied by businesses in Idaho for some other purpose other than the costs of all that testing.

Mr. Chairman, I continue to hear employers state that they have no problem with the general intent of Section 89; however, Congress clearly created a Lochness monster when it enacted Section 89. The regulations will decrease flexibility, increase administrative costs, and ultimately bring about fewer benefits and fewer businesses offering plans.

I have offered several remedies to Section 89 as it now stands on the books. I introduced legislation that will postpone this ruling for one year, allowing us time to further study and decide of we are on the right track with this legislation. We must postpone it, if for no other reason that to send a message to the business community not to drop their benefit programs and wait until a broader knowledge of the implications of section 89 is understood. Yesterday the Senate overwhelmingly adopted Senate Resolution 92, which many of you co-sponsored with me to urge the House of Representatives to take action regarding this legislative headache.

I have learned this morning that the House of Representatives may at last now start to consider a bill to delay this provision, and to make substantial modifications.

Mr. Chairman, I fear that unless Congress acts quickly, the nation's businesses will drop employee benefit plans outright. For a government which claims to be responsible to its constituents, clearly, a call to action is beckoning. That Congress has insisted on turning the tax code into social legislation is beyond me. The way the Constitution is being interpreted these days, perhaps Congress will next institute central planning or five year plans to deal with perceived inequities in what is supposed to be a capitalist, market based society.

Senator **Boschwitz**. Let me ask one question before you leave, Senator. You are on the Finance Committee. Was there some discussion in the Finance Committee about this provision during the course of the mark-up of consideration of the bill?

Senator **Symms**. There was discussion about trying to come up with some fairness.

To answer Senator Grassley's question, the reason for the Section 89 being in the tax code, as I remember it, was there had already been an argument that oftentimes these group health plans in businesses favor certain people that are the owners or higher paid employees to the disadvantage to some of the part-time workers and lower income workers.

I think that even though theoretically people may make that argument, they might be surprised to find out in the real world of business how small companies are in many times that I find the ones that I have been involved in, are like families, and that there is a great deal of interest from the people who own the companies and the people who have worked there for many, many years in that they really do not need the Federal Government intervening on those kinds of issues.

So, that is where it came from, and I cannot recall—I would hope Senator Boren could remember whether it came from the House side or the Senate side—the final end-product. But I do not know why we do not have any House Members here to deny it.

Senator **Lott**. Last year I thought it came from the Senate, but this year I think it came from the House.

Senator **Symms**. I guess I am willing to take my share of the guilt on this because I was on the Committee at the time it happened. We had no idea that this would be the end result, I am certain, when it did happen. But I know from the businesses that I am personally involved in that do have group health plans that we simply do not have the capacity to comply with this. And it is, I think, that we cannot allow people to be dropping these plans because the numbers of people that might be without health insurance and have people in their families, we just simply cannot let it happen.

Senator **Boren**. I think you are absolutely right. My recollection was that as this process moved along, principally Chairman Rostenkowski was insisting on some kind of rule and saying the fringe benefits would all become taxable. We had a choice, more or less. We were looking down the barrel of a gun to either have certain kinds of rules or they were going to tax all fringe benefits, which many of us felt would be very unfortunate and unwise and, again, discourage the kinds of coverage that we are talking about.

And so, as usual, I think, most of the fine print was drafted by staff, never reviewed by Members, and hurried through by the Conference Committee at the end and it is why some of us had enough misgivings that we felt we could not support the bill, at the last result.

But I would guess there are probably not two Members of either Committee that ever had any idea about the kinds of burden that was being put on small businesses across the country by this at the time that it was adopted.

So, I would hope—and I have been hearing more encouraging comments now—Chairmen Bentsen has clearly put himself on the side of being for change. massive change, and I understand that Chairman Rostenkowski has made at least a beginning statement that he will at least look at it.

Senator **Symms**. The Chairman yesterday, Senator, introduced a bill, I was told, that delays the whole thing for 1 year. So, there is absolutely no reason for Treasury to not put out a press release today.

Senator **Boren**. I agree with you.

Senator **Symms**. Save the American people the unnecessary harassment.

Senator **Boren**. So often around here what happens is that you have something terrible happen, and we have gone through this. We went through it with the auto logs. We went through it with a lot of other things.

And unfortunately the businesses often have to go out because they do not know whether they have to comply or not. They spend a lot of money getting ready for compliance and by the time we finally get it repealed, it is too late to save them the money that they have spent in complying. We ought to prevent that, and I agree with your suggestion that the Treasury Department ought to come out with a statement and say that they are going to support repeal or delay.

Senator **Symms**. Senator Lott made a point on the Floor yesterday when he made the statement that when you start hearing from the people who make a living selling the services to small business and big business of how to comply with certain laws, calling up and telling you for God's sake repeal that law, we cannot even tell people what it is supposed to mean—when you get to that point, the people who make a living trying to provide the services of people being able to comply with the law are opposed to it, I think it is time just to act and not delay it.

And it would be a great encouragement to me, and I know to a lot of Americans, if they thought the Congress could respond rapidly on this issue. And I think that is why I compliment all of you that are here. Thank you, Mr. Chairman.

Senator **Boschwitz**. Thank you very much, Senator Symms, and I would add to your testimony that having run a small business as you have for many years, it always grates me when people think that we have no interest in our employees and that we simply are out there to take advantage of them. Clearly they have never run a small business themselves because we in the retail business know that if you take advantage of your employees, you are going to be frustrated in your sale's efforts.

Senator **Symms**. My theory is the best way to be selfish in running a business is to be unselfish with your employees, and you will profit from that. And the market proves that.

Senator **Boschwitz**. We now have as the first witness Mr. Dana Trier, who is the Tax Legislative Counsel of the Office of Tax Policy of the Department of the Treasury. How long have you been there at the Treasury?

Mr. **Trier**. About 1½ years.

I might add, I also came in after Section 89 was passed. I have the ability to deny this.

Senator BOSCHWITZ. Is there anybody with you who was there at the time?

Mr. TRIER. I have, obviously, during the period of time after I became Tax Legislative Counsel, worked with the people who were very much a part of the Tax Reform Act of 1986, and I will spend some of my time trying to at least describe where the impetus for the idea came. I think I understand that fairly well.

Senator BOSCHWITZ. And you were active in the formation of the regulations that have——

Mr. TRIER. Not principally active, but I am certainly ultimately responsible within my office for review of those regulations, yes, sir.

Senator BOSCHWITZ. So, you reviewed the regulations prior to their being issued?

Mr. TRIER. Right.

Senator BOSCHWITZ. Fine, if you would proceed.

STATEMENT OF DANA L. TRIER, TAX LEGISLATIVE COUNSEL, OFFICE OF TAX POLICY, U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. TRIER. Thank you very much, Mr. Chairman. What I would like to do, of course, is to have my statement entered into the record and then briefly summarize what it says and our position on Section 89, ours being this Administration's.

To briefly summarize before I go into some of the background, I think the first thing which is very obvious is that we recognize that there are substantial difficulties with Section 89.

The second, which is in response to your point about the regulations, whether or not those regulations are perfect, and whether or not we could have taken one or two or three steps beyond the regulations to make it more workable, I, at, least personally am convinced that you really have to have quite significant legislative revision of Section 89 to make it workable and, to some extent, I think that talking about the regulations at this point is a pretty academic question.

Maybe the next set of regulations——

Senator BOSCHWITZ. Does that mean that you do not intend to enforce them?

Mr. TRIER. That does not at all mean that. It means that in terms of addressing the fundamental issues that are raised by the administration of Section 89, I think it is time for immediate and full-scale legislative revision of it, and I believe that is the position of the Administration.

So, at this point we really think we have to go very far, as far as necessary, to simplify Section 89. We really think it is a legislative matter and, of course, from the Treasury Department's point of view and the administration's point of view, I am not prepared to respond to all of your suggestions that have occurred in the last 20 minutes. But we really do intend to work very vigorously with you to attack this problem and to participate in the process to see what we can do to make this a workable thing.

Even though I was not there and even though I do not consider myself a faceless bureaucrat, I would like to say a little bit about what the policy impetus was. I have been accused of a lot of things, but not being faceless.

I think the impetus is a very sort of elementary idea that Senator Symms described, which is that we have here, with the exclusion from income for the value of employer-provided health insurance, a very major tax expenditure. Maybe it is one that is very justified, but it is a major tax expenditure.

Our numbers indicate something like $30 billion for this year comes out of that tax expenditure. Now, the primary justification for it is that more health insurance is going to be provided for employees of employers. It is thought that if, in fact, employers are going to provide health insurance for their employees, not only should they do that for the higher paid or the higher compensated employees, but they ought to cover a wide range, at some level, of their employee groups.

Now, as has been said several times here today, I think it is fair to say that there was not at the time of the 1986 act any concrete evidence that major groups of the employees of companies were going uncovered. There was some evidence—there continues to be some evidence in drawing on my own practical experience—that in some employers at least there was executive-only health insurance plans.

I myself represented quite a few small businesses in practice. I tend to agree with Senator Symms that many of them were conducted like families and, in fact, I did not see wholesale discrimination.

But, in any event, I think there was a natural—whether or not we agree with what the outcome was—there was a natural policy impetus, and that natural policy reason that people thought that non-discrimination rules that had been applicable in the pension area, for example, or for a group term life or whatever, should also be provided for employer-provided health insurance which represents a very major tax expenditure, as I said.

Now, we all know today that the practical impact of the legislative provision that came out of that policy concern has been quite unacceptable.

I would like to say a few things about that so that at least we can define what the issues are before us.

I think that there are several reasons for it. One is that Section 89 went beyond just preventing executive-only type of plan, but it really went into fine-tuning the amount of benefits that had to be provided to the rank and file. I think once you have fine-tuning, you have more complicated law, more complicated regulations, and so forth.

Now, second, I think the most persistent problem and the problem that most people that we have talked to—and I might add that this is becoming a major portion of my workload at the moment to talk to people about Section 89—the most persistent problem arises when valuation and actual testing is required under Section 89.

If you have a small employer trying to comply with Section 89 under the rules in a situation where they are forced to value what benefits are provided to each of the employees on a given testing date and perhaps some later testing dates, it is really in the broader scheme of things a quite onerous requirement.

Now, the people who were in on Section 89 in the 1986 act were not completely inattentive to that problem, and they have—one of the two tests, one of the two methods for complying with Section 89, the so-called 80 percent coverage test, was in part, at least at that point in time, and it has evolved since then after TEFRA, it is in part intended to make it easier for small employers because the theory was if you had a plan, there was just a basic, garden variety plan, covered all people the same way, and 80 percent of your employees benefited under the plan, then you would comply.

And what we have found in practice and I think all of us have learned a lot in the last 2 or 3 years—I learned partly before I got to the Treasury Department and I am still learning more this week—is that that way of dealing with the particular problems of the small employer has turned out not to really represent an answer to it; that is, that 80 percent test really applies in too few cases.

All it takes is providing a couple of options or having an employer that has more than one plan or whatever, and that becomes a very difficult test to rely on. In that case, you are back into this valuation and testing situation.

And once you are into that situation, the small employer, because of the incremental costs involved, is in a particularly bad situation, although I am the last one to say that this is not in some level a problem than is shared by small-, large-, medium-sized—all employers around the country. It is, in operation, a very complicated statute.

As I said earlier, our view, certainly my view, having reviewed the regulations and thought about some of this, is that the repair is really beyond a legislative fix. Consequently, we really support what is obvious to us; a very vigorous effort not only of the tax-writing Committees, but Senators and Congressmen who are not on the tax-writing Committees to immediately attack this problem, whether it would be by specific fixes or the major surgery referred to in Senator Bentsen's remarks. We intend fully to work with you at all levels of the administration, including the faceless bureaucrats like myself, to help to formulate a reasonable proposal.

I frankly think that it has to look very significantly different than the existing legislation. At the same time all that process is going on, we also have to point out we have to be attentive to the revenue considerations, how it fits into the budget process, the budget negotiations, and so forth.

Obviously there has been a lot of action just in the last 24 hours in that respect, and also at least be cognizant of what the original impetus for this legislation is, even though we all understand and we fully acknowledge that in its operation and in its effect and in many of its specific provisions, the statute was quite simply ill-considered and ill-conceived. So, that concludes my summary and my remarks. I would be happy to take any questions from you.

[The prepared statement of Mr. Trier follows:]

For Release Upon Delivery
Expected at 9:30 a.m.
April 13, 1989

STATEMENT OF
DANA L. TRIER
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the Administration's views regarding the impact on small businesses of the nondiscrimination rules of section 89 of the Internal Revenue Code. The Administration recognizes the difficulties posed by section 89 for small businesses. Because we are aware of these difficulties, the Administration supports continued efforts to simplify the application of section 89. We believe, however, that the Treasury Department and Internal Revenue Service cannot, by regulation, go any further in simplifying section 89 without enactment of legislation. The Treasury Department looks forward to assisting Congress in fashioning a legislative solution.

In the first part of my testimony, I will describe briefly the background of section 89, the policy rationale for its enactment and certain positions taken in the proposed regulations. Then I will discuss the principal problems with the application of the statute to small businesses. Finally, I will conclude by summarizing the Administration's position on modification of section 89.

Background and Policies

The enactment of section 89 had two basic effects. First, a uniform set of nondiscrimination rules was made applicable to the wide variety of employee benefit plans previously subject to different rules, such as group-term life insurance plans and self-insured medical plans. Second, nondiscrimination rules were made applicable to employer-provided health insurance, which was previously not subject to such rules. It is this latter effect of section 89 that is the most far reaching in its impact.

The Internal Revenue Code generally provides that the value of employer-provided health coverage is excluded from income. The primary purpose of this exclusion is to encourage employers to provide health coverage to their employees. The President's 1990 budget reports that the revenue loss tax expenditure for employer-provided health coverage in 1990 will be $29.6 billion.

Section 89 conditions this tax benefit by providing that employer-provided health coverage may be excluded from the income of highly compensated employees only if coverage is also provided on a nondiscriminatory basis to nonhighly compensated employees. In the event employer-provided health coverage is found to be discriminatory under section 89, the value of coverage is included in the income of highly compensated employees as wages.

The rationale for the conditions imposed by section 89 was that the tax expenditure for the exclusion from highly compensated employees' incomes is justified only to the extent employers provide nonhighly compensated employees health coverage generally comparable in value to the coverage received by highly compensated employees. The legislative history of the Tax Reform Act of 1986 indicates that Congress was concerned that the rules formerly applicable to certain employee benefits, particularly health insurance, did not require sufficient coverage of nonhighly compensated employees as a condition to the exclusion; the tax benefit afforded to highly compensated employees receiving employer-provided health coverage could not be justified without broader coverage being mandated.

Under section 89 an employer may choose to test its health plan to determine if the plan satisfies the nondiscrimination rules under one of two methods. Under the first method, a plan satisfies the rules if it satisfies two eligibility tests and one benefits test. The first eligibility test is that at least 50 percent of the plan participants must be nonhighly compensated. Satisfaction of the test ensures that the plan is not designed to benefit primarily highly compensated employees. The second eligibility test is that at least 90 percent of the nonhighly compensated employees must be eligible for a benefit at least equal to 50 percent of the greatest benefit available to a highly compensated employee. Satisfaction of this test ensures that minimum health coverage is available to most employees. The benefits test is satisfied if the average employer-provided benefit received by nonhighly compensated employees is at least 75 percent of the average employer-provided benefit received by highly compensated employees. This test is designed to ensure that nonhighly compensated employees actually benefit under the plan. In addition to meeting these tests, a plan may not contain any provision relating to eligibility to participate which (by its terms or otherwise) discriminates in favor of highly compensated employees.

Under the second method, a plan satisfies the nondiscrimination rules if it benefits 80 percent of the employer's nonhighly compensated employees. This method is available, however, only if the plan in question meets the general requirement that it not contain any discriminatory provision relating to eligibility to participate.

The definition of highly compensated employees under section 89 is the same as that used for other employee benefits. The Internal Revenue Code generally defines a highly compensated employee as any employee who, during the current year or the prior year, is one of the following: (i) a 5 percent owner; (ii) an officer receiving compensation in excess of $45,000; (iii) an employee receiving compensation in excess of $75,000; and (iv) an employee receiving compensation in excess of $50,000, who is among those 20 percent of employees receiving the greatest compensation from the employer. The Code provides that the relevant dollar amounts will be indexed for inflation.

When testing its health plans, an employer generally may exclude those employees who have not completed six months of service, those who are not yet age 21, those who normally work less than 17-1/2 hours per week, those who normally work not more than six months per year and nonresident aliens receiving no United States source income.

In recently promulgated regulations, the Treasury Department and Internal Revenue Service have attempted to be as flexible as legally possible to assist employers in bringing their plans into compliance with section 89. The proposed regulations implementing section 89 that were published on March 7, 1989 provide several transitional provisions that will enable employers to comply more easily with section 89 in 1989. First, the proposed regulations provide that employers who reasonably and in good faith comply with section 89 and its legislative history in 1989 will be treated as having satisfied section 89. In addition, employers may generally ignore facts in existence prior to July 1, 1989 when testing their plans for compliance in 1989. Employers who choose to take advantage of this relief merely annualize the benefits provided after July 1 to determine whether their plans are discriminatory. Lastly, the proposed regulations provide that employers who elect not to test whether their plans satisfy the 75 percent benefits test in 1989 may include in the income of certain of their highly compensated employees all of the employer-provided health coverage. This election relieves employers of most of the data collection and testing burdens. The highly compensated employees who must include in income all of the employer-provided health coverage are the 20 percent of such employees who receive the greatest compensation from the employer, but not less than ten employees nor more than 2,000 employees. This transitional provision is extended to 1990, except that the number of highly compensated employees who must include all of the employer-provided health coverage in income is greater.

Impact on Small Businesses

In formulating section 89, Congress was to some extent attentive to the particular situation of small businesses. Thus, for example, the 80 percent coverage test described above was originally intended, in part, to facilitate section 89 testing for small employers. The expectation underlying this test was that certain employers, especially small employers, might have very simple benefit structures under which substantially all employees are covered under one plan or a few very simple plans. It was thought that because of the availability of this test, many small businesses would not have difficulty in performing the nondiscrimination test; for such employers, a single, simpler test could be used, and the application of the three-part test would be unnecessary.

Nonetheless, it is clear that section 89 raises significant compliance problems for many small businesses as well as other employers. The principal difficulty arises when the employer is required to value the benefits actually provided under the plan. In some cases, valuation will not be necessary, as for instance, if an employer provides a single plan that satisfies the 80 percent test, or provides several plans that may be deemed comparable without benefit valuation and that together pass the 80 percent test. Valuation, however, may be required, for example, if more than one plan or option is provided.

To the extent valuation of benefits is required, those small businesses that provide health coverage to most of their employees may have particular difficulty in applying the nondiscrimination tests. In order to determine whether its health plans satisfy the three-part nondiscrimination test of section 89, an employer is required to test its plans on one day of the year, taking into account the facts in existence on such day. This test requires an employer to value the employer-provided health coverage actually received by each of its employees. In order to do this, an employer must identify those of its employees receiving employer-provided health coverage on the testing day and must ascertain the value of such coverage using any reasonable method, including the cost of coverage. If any highly compensated employee elects to receive health coverage on a day other than the testing day that has a value different from the value of the health coverage provided on the testing day, then the employer must take into account the values of the health coverage provided to the highly compensated employee in determining the value of the employer-provided coverage provided to such employee during the year.

In addition to the general problems of testing and valuation, we understand that one of the most significant problems that some small businesses encounter in applying these tests relates to the pricing of the health coverage offered by insurance companies. Many small businesses are required to pay insurance companies individual annually rated premiums rather than level-rate group premiums. As a result, such a business is precluded as a practical matter from using the cost of health coverage as its value, because the cost of a highly compensated employee's coverage may be much greater than the cost of the coverage provided to a nonhighly compensated employee even though the same benefit schedule covers both employees. In addition, small businesses whose insurers refuse to provide health coverage to part-time employees may be unable to satisfy the nondiscrimination tests of section 89 if such businesses have a significant number of part-time employees. Finally, because small employers have a limited employee population, changes in the composition of the work force may have a significant impact on testing results.

Conclusion

The Administration fully understands the problems employers are experiencing in complying with section 89. It is clear that many of these problems were not fully understood when section 89 was drafted and that parts of the statute were ill-considered. At the same time, we fully recognize the competing policy objectives as well as revenue considerations. Accordingly, we want to give full latitude to the tax writing committees to consider these issues, and we intend to work with them to fashion appropriate revenue neutral legislation.

This concludes my prepared remarks. I would be pleased to respond to your questions.

Senator **Boschwitz**. Let me begin the questioning with—your testimony was unusual. You seem to be in opposition to the regulations you just issued, and so you said that you frankly feel it should look very different than it does.

Why did you issue these regulations in that case?

Mr. **Trier**. I would like to clarify it if that is the opinion that you get from it.

One of the unfortunate aspects of my position is that part of what I do is enforce the law as it is written and write regulations to interpret it as it is written.

And I believe that there are two things true of the regulations. One is that I think they are completely consistent with what the law says and, in fact, in honesty I think we went, particularly with respect to the transitional relief provided, some of us had to gulp a little bit to go as far as we did in providing the transitional relief.

That does not mean that we think that those regulations solve the inherent practical difficulties presented by Section 89.

I am not calling in to question our regulations. In all the regulations we issue, I end up finding that I wish I had done something a little bit different. But I am not attacking the regulations at their core. I think the basic problems, just to reiterate, we would say that the basic problems, the fundamental problems, not a little change here or there around the edges can only really be addressed by legislative modifications.

Certainly from my perspective and where we put our resources in dealing with Section 89 over the next couple of weeks or the next month or two, I think we ought to concentrate on that aspect.

Senator **Boschwitz**. Do you think we ought to repeal Section 89?

Mr. **Trier**. I am unprepared to say that at this moment. Certainly the administration has not come to that position yet.

We do think that very fast and vigorous attention needs to be paid to it, certainly from the Treasury Department's point of view. Again, at my level and below, we are paying most attention to the specific proposals for, as Senator Bentsen said, major surgery.

Senator **Boschwitz**. I would say to you, Mr. Trier, that your last two questions have more or less defined what some people believe a faceless bureaucrat to be, kind of beating around the bush.

I gathered from your earlier answers that you did not have much sympathy with Section 89 and recognized the complexity. The rules and regulations that have been kicked around the table here, as I understand it, are incomplete; they do not cover employers who have multiple plans.

Mr. **Trier**. Multi-employer plans, that is true.

Senator **Boschwitz**. If you have 200 pages turned out for employers who have single plans, it is really going to be extraordinary when you come out with employers who have multiple plans, and I am afraid that my company fits into the latter category.

When do you think that you are going to come out with them?

Mr. **Trier**. We are working on all of the Section 89 regs as well as the remaining portions of the Tax Reform Act's pension regs just about as hard as one can work on them. On the other hand, I think that the next few weeks will determine a lot about exactly what our long-term efforts are on lengthy regulations implementing the statute.

Senator **Boschwitz**. Why was the 2-year lead time—did the Treasury fail to issue comprehensive guidelines or guidance regulations before the effective date of Section 89 even after Congress imposed a specific date, I believe November 15, 1988, for the issuance of such regulations?

Mr. **Trier**. Senator or Mr. Chairman, there are two explanations for that. I never want to defend not having issued all the regulations on laws passed in 1984, 1986, 1987, whatever, but I think the first explanation is that the particular Section 89 package and especially the first package was, in fact, delayed to some significant extent because—it was delayed to some significant extent because as the consideration of modifications to Section 89 which were made last year, as you know, was going on, we held back until we were sure exactly how the statute was going to come out as a result of the technical corrections.

The second explanation, sitting from where I sit, is quite obvious, but I must say that—it is quite obvious, but that does not present it as any excuse.

We are inundated with major regulation projects as a result of 1984, 1986, and 1987 legislation. Indeed, there are aspects of the 1984 act that we do not have the regulations out on yet, and that is no excuse, but I must say the work burden for the people working on it is quite extreme.

Senator **Boschwitz**. So, that in the event that my business got delayed for a couple of years, as you have, in putting out these regulations, you will not mind?

Mr. **Trier**. As you know, the transition relief provides that for this year so long as you reasonably rely upon the legislative history in complying with Section 89, that the Internal Revenue Service will not attack your plan.

Senator **Boschwitz**. When do you expect to come up with regulations for multi-employer plans?

Mr. **Trier**. I would not want to give any specific date, but they have been worked on—they are being worked on for several months, and they are among the first set of additional Section 89 regs that we hope to issue later this year.

Senator **Boschwitz**. Have you made any estimates of the cost of compliance with these regulations and whether or not the Treasury is going to lose or gain revenues because of all of this?

Mr. **Trier**. I will take that as really two separate questions, and the first point, we do not, in fact, have a concrete estimate of the cost of compliance.

The economists in the Office of Tax Analysis working on this matter are going out of their way to collect statistical data. Many of the same groups who have come in to talk to you have been very helpful to us in providing us with that data, and we are assembling it and analyzing it. Whatever is true, I think it is apparent to all of us that those costs are quite significant.

As to the revenue effects and the implications of the revenue effect for that compliance effort, again, we have not modified our estimates based on that, but I would say this, that one does have to be careful in analyzing that particular type of situation.

The same activity that is paid for and is deductible by the corporation that is doing the Section 89 compliance, gives rise to income to the providers of all the services, the people who write these massive manuals and consult with people at the corporation.

Senator **Boschwitz**. So, you agree this is kind of a lawyer and accountant relief act. But suppose we hire somebody who would not necessarily mean an expansion. I suppose he will make our accountant work harder. He is not working on an overtime basis, however, that is an interesting way to look at it, you have created some income as well. Maybe that was some of the purpose.

Do you intend to enforce these regulations, particularly with respect to multi-policy employers or even the single policy regulations? How do you intend to enforce them? It took you over 2 years to write them, and then you made the excuse that, well, you wanted to see what happened in the 1987 tax bill. What was it called? The technical corrections—a few technical corrections. So, therefore, you do not write the regulations, but how are you going to enforce this?

I have heard that the Treasury may not be too obstreperous in seeking enforcement?

Mr. **Trier**. Well, I cannot speak to that particular thing because obviously the Commissioner of Internal Revenue enforces it, not the Office of Tax Policy. Ultimately the Secretary of the Treasury is in charge of that.

I think there are really a couple of points there. One is that we are going to enforce the law until drastic action is taken, at least, and I will go back, by the way, to the Treasury Department with some of these suggestions that were made here until we fully analyze them.

We are charged with the enforcement of the law, and we will within the spirit of the law be required to enforce it. However, as late regulations are issued, as changes are made, and as all these things occur, obviously in the regulations themselves, or by notice or otherwise, we fully take into account the burden that has been placed on, the timing problem that has been posed for employers, and the result—the first set of Section 89 regulations was really to say that the regulations were not what they had to comply with initially.

It was with a good faith reasonable effort to interpret the statute for this year, and I would presume that when the multi-employer plan regulations come out that some similar type of transitional relief would be provided.

Senator **Boschwitz**. I now turn to Senator Boren, but I note that we have some additional Senators.

I would say to you, Mr. Trier, that I am not sure you have testified before a Senate Committee, but we have had remarkable attendance here this morning in this Committee and it is indicative of the interest that there is in this issue. And, you know, your testimony, when you say that regretfully you find yourself with this law, and you become apologetic for the law, but then you insist that you are going to have to go forward, and so forth.

Please take the word back to your Department that we, indeed, are serious about this as evidenced by the——

Mr. **Trier**. I testified several times, and I must say there is triple the number of people here than there usually is.

Senator Boschwitz. Before we begin with you, I would ask the Senator from Michigan. Do you have an opening statement?

Senator Levin. I will make that part of my questioning. Thank you.

Senator Boschwitz. Senator Harkin.

Senator Harkin. Thank you, Mr. Chairman.

I just wanted to ask that my statement be made a part of the record.

Senator Boschwitz. But, we were not turning to you for questions, but just for an opening statement.

Senator Harkin. Yes, but I am saying, I want to make it further—I just want to make just a couple of comments on my statement.

Senator Boschwitz. Fine.

Senator Harkin. And I hope that we will focus some attention here—I know you have some people from Minnesota here on the effect on small towns and communities.

I know we have heard a lot from small businesses and what has happened to them. But I can tell you, there is an outcry happening across the State of Iowa from our small towns and communities, many of whom have maybe one employee, part time, conducting the business of the community of maybe 1,500 or 1,000 people, and for them to be involved in trying to figure out how to apply Section 89 is driving them nuts.

They are going to have to hire outside consultants, spend all this money—something has got to be done and done very soon, so that all these communities—I know across all of our States, especially the smaller ones, are not so adversely affected by this new law. So, time is of the essence, Mr. Chairman. Time is of the essence.

STATEMENT OF HON. CARL LEVIN, A U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator Levin. Mr. Chairman, let me just briefly say, because I do not know how much time will be taken up before we get to questions, it is clear that Section 89 is a mess. And the only question in my mind is how quickly is Government going to clean up the mess?

Now, if that raises some echoes of another mess that we have not cleaned up very quickly, that is what is intended.

The small businesses in my home State of Michigan, small businesses around the country are—they need action now. At a minimum, they need the delay in the implementation of this. They do not need another vague standard, which is the good faith standard. That is not a clear statement to businesses as to whether or not they have got to comply with this mess or not.

Now, I would hope, at a minimum, that the Treasury would support a delay in the implementation of Section 89. That seems to me to be the absolute, minimum position that you ought to take.

Now, I have not yet heard from you this morning on that position. We can save that for questions, but it is not going to be enough to simply say that you are not going to enforce poor regulations that are complied with in good faith.

If the regulations do not make sense, we ought to put them on a shelf; we ought to hold off implementation of Section 89. It was a terrible mistake—part of a tax bill, by the way, which I thought was a mistake. But that is another issue.

But at a minimum, I would hope Treasury would make a cleancut statement this morning saying, "We are going to delay the implementation of Section 89. We are not going to penalize people for not complying with Section 89, just the way we finally did in the W4 fiasco last years.

Senator **Boschwitz**. I think that you are the only one among us who voted against the tax bill. You voted against it?

Senator **Boren**. I voted against it.

Senator Wallop. I did too.

Senator **Boschwitz**. Senator Wallop, do you have any opening statements?

Senator **Wallop**. Mr. Chairman, I have an opening statement, but I would be pleased to submit it for the record, and just say that we have a man named Mr. Morris here from True Oil Company in Casper, WY, and another gentleman from Wyoming, whose illness made it impossible for him to testify here today. And I would like to submit his statement for the record.

I would just observe, Mr. Chairman, that a few years back, I held hearings in the Finance Committee, and in the Senate Energy Committee on tax re-exchanges or land exchanges. And the witness from the Treasury Department came and his opening statement says, "We, at Treasury, collect taxes, and that is what we do."

That has never been doubtful in my mind. But, what is doubtful in my mind is whether anybody in Treasury knows the English language? Because that is where the problems come from—is trying to translate the intentions of Congress and other things into something that is discernible for the average human being.

In America, I think it is clear that we are probably the greatest compliers with tax obligations in the world, and nothing does us more harm than regulations which are either indecipherable, or impossible to comply with when deciphered.

I think we have got a case of both of those here, and this has become the sort of auto logs of 1989. And I am as anxious as, I think, everybody here is, not to indulge so much in criticism, but to get it resolved and get it out of the way, so that some confidence in our tax system can be reestablished.

Thank you.

[The prepared statements of Senators Wallop, Kerry, Nickles, Domenici, and Harkin, follow:]

STATEMENT BY SENATOR MALCOLM WALLOP BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS REGARDING SECTION 89 OF THE INTERNAL REVENUE CODE

THURSDAY, APRIL 13, 1989

Mr. Chairman, I'd like to thank you and the ranking minority member, Senator Boschwitz, for holding these hearings on Section 89. As I'm sure many of my colleagues would agree, this issue has become the "auto logs" issue of the 101st Congress, and I welcome this opportunity to discuss the ramifications of Section 89 on small businesses in this forum. Like a number of my distinguished colleagues, I have received many, many letters from the small business community in my State of Wyoming expressing concern about the complex and intricate regulations recently issued by the Treasury Department on compliance with Section 89. The majority of folks in Wyoming which wrote me about this issue probably complained more about the fact that although they had to comply with this law as of January of this year, the regulations were not published in the Federal Register until March 2. With that in mind, it would appear that not only were the small businesses having a difficult time complying with the law, but the IRS was apparently having an even harder time writing the regulations in plain English.

Because of the numerous concerns raised by my constituents, I have cosponsored two of the four pieces of legislation now pending before the Senate -- the Symms bill which places a one-year moratorium on the implementation of Section 89 and the legislation to repeal it introduced by a distinguished member of this committee, Senator Lott. I commend these two gentlemen on their leadership on this issue and look forward to their comments today. I also note that Senator Domenici, the author of legislation to simplify Section 89 is here before us today to testify and perhaps his perspective will assist us in our efforts to reach a consensus on how best to resolve the various problems with this burdensome section of the Internal Revenue Code.

I would like to welcome to this committee Mr. Ron Morris, the tax counsel for True Oil Company in Casper, Wyoming. Mr. Morris is here at my request to represent the interests of a company of more than 400 employees and his testimony should prove helpful to the committee in outlining the problems with Section 89 compliance. I regret to say that due to health reasons Mr. Jim Helzer of Unicover Corporation in Cheyenne, Wyoming could not appear before the committee, but I am pleased to submit his thoughtful testimony for the record. I have several other statements and letters from interested parties in Wyoming which I will submit for the hearing record as well.

Mr. Chairman, if I may, I have a few questions that I would like to ask of (submit for) Mr. Trier at this time.

NAGEL Motors
Buick Pontiac Cadillac
Jeep Eagle
Built on CONFIDENCE

April 12, 1989

The Honorable Malcolm Wallop
Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Wallop:

I appreciate the opportunity to explain the problem that I, as a small business owner and probably most small business owners as well, face in trying to comply with Section 89 of the Internal Revenue Code. In order to help you and the members of your committee better understand these problems that I face, it might help for me to describe my business and the types of benefits that we offer our employees.

Nagel Motors is an automobile dealership located in Casper, Wyoming. We have been in business for over 40 years, employ about 50 people, and sell about 350 new cars and 500 used cars per year. Compared to the 25,000 dealerships across the country, we are considered an average-size dealership. Last year, our total sales equaled $11,600,000 and our total payroll, including fringe benefits and payroll taxes, equaled approximately $1,500,000. Like most businesses in Wyoming, we have been fighting a poor economy and struggling to survive for the last six years. This is somewhat reflected in the small after-tax net profit we had last year of only 1.15% of total sales.

Through all of these poor economic conditions, however, we have been able to maintain a good benefits package for our employees. We have a group hospitalization insurance program for all our employees through Blue Cross/Blue Shield, in which our company pays 100% of the employees' premium. We also have a retirement pension plan for all employees through NADA (National Automobile Dealers Association) where our company matches the first 2% of the employees' investment in the plan. In addition, we offer life insurance coverage for our key employees. We also pay one half of the uniform expense for our technicians and one half of the insurance for the technicians' tools in case of major loss. Including FICA, Workmans Compensation and vacation pay, the cost of our benefits program last year was 1.61% of total sales. This is greater than our after-tax profit by nearly 0.5%!

It is clearly in the interest of business, large or small, to have the flexibility to offer key employees whatever salary compensation and benefits package is necessary to be competitive in the marketplace at a reasonable cost. Being able to attract and keep high-quality key employees is vital for our survivability in these hard economic times. Our profitability helps insure that we can employ more productive workers and provide better benefits for them as well. This is beneficial not only for business, but also achieves the desire of Congress in finding ways to increase employer-provided health insurance and retirement coverage. For this to be effective, however, it is important that Congress does not place excessive financial and administrative burdens on employers that restrict their ability to provide cost-effective employee benefits. Section 89 places so many discriminatory restrictions and administrative burdens on employers, that they no longer have this necessary degree of flexibility to compete for good managers in a cost-effective manner.

I represent the dealers from the State of Wyoming as a Director on the National Automobile Dealers Association Board of Directors. In this position, I travel our state extensively and have the opportunity to discuss major legislative issues with our dealers. The majority of our dealers represent small employers, employing under 50 people, and many have stated to me that Section 89 is extremely complex, difficult and expensive to administer, and very costly. Our dealers generally agree that the intent of Congress to broaden health care coverage is admirable. Unfortunately, Section 89 makes administration of benefit plans so difficult that the opposite effect is the probable result. It will be easier and less expensive for dealers to drop coverage, than to attempt to comply with the discriminatory guidelines and testing procedures. In my own situation, where my employee benefits cost is already higher than my after-tax profit, it does not make sense for me to continue to offer employee benefits under Section 89 where my costs will be forced even higher. I may be forced to either reduce benefit coverage or reduce staff.

At the very least, the time required to ensure compliance has reduced other productive endeavors that I must perform. I will probably be forced to hire an outside consultant in order to insure compliance with Section 89. To determine whether we comply with the law, we must gather data and perform tests for every coverage option available to every employee, for both single and family coverage, determining all employee contribution and coverage levels. For every plan, we must calculate the total value of the plan's benefits and perform complex statistical evaluations determining the level of benefits received by all employees.

Section 89 is making benefits plans so difficult to administer, that many dealerships may be forced to reduce or eliminate insurance and retirement coverage for employees altogether. At a time when Congress is concerned with finding ways to expand employer-provided health insurance and decrease rising Social Security costs, Section 89 is simply not the right course of action. Therefore, I urge you to delay implementation of Section 89 until Congress can dramatically reduce the discriminatory provisions and administrative burdens now in effect.

Sincerely,
Robert W Nagel
Robert W. Nagel
President

RWN/mjp

XEROX TELECOPIER 295 ; 4-12-89; 8:25 AM; 307 265 8554 → 2027675896 ; # 1
APR 11 '89 17:13 FROM WOTCO MLLS PAGE.001

WOTCO
WESTERN OIL TOOL AND MFG. CO.. INC.
POST OFFICE BOX 260 CASPER, WYOMING 82602 PHONE (307) 235-1591
TELEFAX: 307-265-8554

COMPANY: The Honorable Malcom Wallop DATE: 4-11-89
FAX: 202-224-3230 ATTN: Marian Jacobs
PAGES (INCL THIS) 1 FROM: R. L. McCall

IF YOU DO NOT RECEIVE ALL THE PAGES, PLEASE CALL SHARON AT (307) 235-1591 AS SOON AS POSSIBLE.

MESSAGE: I am associated with Western Oil Tool & Mfg. Co., Inc., a steel fabrication facility in Casper, Wyoming, employing 227 people.

We have a serious concern with the potential impact of Section 89 on the medical and life insurance program which the company has for its employees.

In an attempt to minimize the risks of penalties to which the company and/or its employees might be exposed, we have retained the services of an Employee Benefits Consultant, at a substantial cost, to help us in complying with Section 89. We do not have the expertise or the manpower in house that would be necessary to accomplish the requirements it imposes.

We would hope that the Congress might reconsider the impact of this requirement on the business community, and especially on smaller businesses which normally are faced with much more limited resources.

EL FABRICATORS □ DESIGNERS □ ENGINEERS □ MACHINISTS

1988
EXPORT E EXPANSION

TESTIMONY
OF
RAY LANSING
FOR THE
SMALL BUSINESS COMMITTEE
OF THE U. S. SENATE
SECTION 89 OF THE
INTERNAL REVENUE CODE

Mr. Chairman, and members of the committee. I appreciate the opportunity to enter these remarks in the hearing on Section 89 of the Internal Revenue Code.

I have a small business, an advertising and public relations firm in Cheyenne, Wyoming. When I say "small" business, I really mean it!

In addition to myself, I employ two staff members. One works an average of 32 hours per week; and one works an average of 16 hours per week.

The reason for doing this is that although, both are working mothers they still want time home with their young and growing families, and we have been able to accomodate them with this "flex-time" scheduling.

For some time I had been considering offering health insurance as a benefit, even though they both had various kinds of health insurance of their own.

However, when I ran into Section 89 of the code....it stopped me in my tracks! I tried to "figure out" what the so-called non-discrimination rules are.....but I learned that the IRS has not issued regs on how to comply...this was around the first of the year.

I subsequently wrote to both my Senators Malcolm Wallop and Alan Simpson and received replies from both. I hope these hearings will result in some action on this subject....namely to repeal it.

I cannot afford to have an expensive accountant or lawyer trying to keep me "straight" just because I want to help my employees. In my opinion, compliance is too complicated and expensive.....so at least for now, I have chucked the whole thing.

I also am uncertain about employee tax liability from year to year, and if I give one of my part-time employee a little more work, they will have to be given benefits too.

I can tell you that Section 89 certainly affected a small business in Cheyenne, Wyoming just because of its uncertainty and difficult rules.

I heartily endorse repeal of Section 89.

Thank you for your consideration.

LARRY G. BEAN, C.P.A.
307-234-7717

BAILEY SCHOOL & OFFICE SUPPLY BLDG.
820 S. WALNUT
SUITE 102

P.O. BOX 3732
CASPER, WYOMING 82602

April 10, 1989

The Honorable Malcolm Wallop
United States Senator
204 Russell Senate Office Building
Washington, D.C. 20510

Malcolm:

You "made my day" when you called on Thursday, last. Your contact was very positive for many reasons:

1. We all appreciate your continued efforts in being a "champion" for small business and the citizenry of the State of Wyoming.

2. Your position in reference to redrafting and/or (hopefully) deleting this negative law - Internal Revenue Code Section 89 - is much appreciated.

3. You honored me in requesting my thoughts and comments; and inquiring if I would be able to testify. I was deeply saddened that I could not rearrange my schedule to be in attendance. The matter is of SIGNIFICANT IMPORTANCE.

   I conversed with Mr. True and Diemer True and they indicated that their tax attorney, Ron Morris, will be in attendance at the hearings.

4. It's always great conversing with you. You are a very special person and represent Wyoming in a positive manner.

I have enclosed approximately 12 letters from various individuals, businesses, etc., which reflect their concerns and opinions regarding Internal Revenue Code Section 89. The impetus of the concerns vary; however, there are a few "common threads":

1. Why is the law needed?

It appears that some government bureaucracy (administrative branch of the government) compiled a study which indicated an "erroneous conclusion" that small business is not being fair with it's employees. As you can quickly note from reviewing the enclosed communication and to the best of my knowledge I can verify, most small businesses include the majority of their full-time employees in all fringe benefits.

2. The cost of implementation of the law, both at the governmental level and at the employer level.

It appears the Treasury Department is continuing it's efforts to "build an empire" of needless paperwork and having individuals inside their "empire" to justify existence.

The filing of forms, the compliance rules, the studies which employers must undertake, and the time factor are, in my opinion, unnecessary.

Small businesses have enough paperwork, outside government control and expenses. I question additional compliance rules and regulations, filing of forms and unproductive expended time.

The productivity in this great country is decreased. Much of that is due to "bureaucracy induced paperwork".

3. Time. I conversed with various trust departments, employers and accountants. It is their estimate that small entities would have to expend 8 to 25 hours of time for compliance. Larger entities encounter greater difficulty, as the time expended has a multiplier effect.

This is time that the employer must expend on an annual basis. It does not include time expended by professionals.

4. Lost funds - a firm from Omaha is offering it's services to test "compliance, for the minimal fee of $3,500 per plan.

Malcolm, small businesses in Wyoming cannot afford $3,500 per plan.

Millard Meredith, Superintendent of Schools, in Douglas, Wyoming (letter enclosed) indicates the cost will range from $3,000 up to $9,000 just for the compliance testing. In addition, there will be the completion of forms, communication with employees, lost time. Adding these all together, the cost will range from $6,000 to $15,000.

The question must be asked: What are the positive attributes of incurring these expenditures? Will the school district cover any additional employees?
In conversing with trust officers and accountants, they anticipate the time for preparation of new "legislated tax forms" will range from a minimum of 3 hours up to 50 or more hours on larger employers.

5. Complexity of the law and ambiguity to regulations. Each individual with whom I conversed had his own interpretation of the new laws, compliance requirements, dates, forms to be filed, exceptions, etc.

Enough rambling - the original intent of those who supported this legislation was undoubtedly constructive; however, I question whether or not this "original intent" has been put into writing in "Internal Revenue Code Section 89". In my opinion, the law serves no useful, economic, constructive, beneficial and/or socially redeeming purpose. It appears to be an attempt to legislate a concept and, I might add, an ill conceived, unverifiable concept.

I appreciate your positive support and I trust you will not feel I am being negative and/or sarcastic. This area of the law and other areas about which we have conversed (more notably, the complexities of the Tax Reform Act of 1986 and burdensome penalties) need review.

Thanking you again for your support, I wish you success in your endeavors to delete this legislation and also in all of your future endeavors to represent the citizenry of the state of Wyoming and the entire United States. If I can provide more information and/or assistance, please feel free to contact me. Also, if I can be of assistance in future hearings, it would be my honor to testify.

Have a good day and give my regards to French.

Respectfully submitted,

Larry G. Bean

LGB:jf

Enclosures:
- Monte L. McNamee
- Converse County Memorial Hospital
- School District #1 - Converse County
- Ray Stockhill
- Harold Robirds
- Thatcher & Sons
- Richard Bratton
- El Jarro Family Restaurants
- Chris Muirhead
- Representative Gail D. Zimmerman
- Gerald T. Stack
- Don Robirds
- David Kreycik

Other individuals with whom I have conversed, who indicated would forward communication directly to you:

- Tom Thorsen, Black Hills Bentonite
- Dick McCall - WOTCO
- Mike Romanjenko, Hilltop National Bank
- Brad Johnson, Freeburg & Company
- Yellowstone Electric
- John Lichty, McGladrey & Pullen
- Bob Nagel

HILLTOP NATIONAL BANK

COUNTRY CLUB ROAD • PHONE [illegible] • P.O. BOX 2680 • CASPER, WYOMING 82602

April 10, 1989

Senator Malcolm Wallop
United States Senate
204 Russell Senate Office Building
Washington, D.C. 20510

Re: Section 89

Dear Senator Wallop:

Finally we have employers putting together employee benefit packages, going to all the trouble of carefully constructing and custom designing the advantages the employees need and deserve - much like a shiny, new automobile rolling off the assembly line in Detroit. But, unlike Detroit, - just as the finished product sees the light of day - there, in the parking lot is a crew of regulators feverishly working to dismantle the vehicle so carefully and painfully put together. And rather than an intelligible mechanism to impart benefits to employees, we are, instead, left with a benefit package that the employer wishes was never constructed, is unwilling to throw away, but realizes would be too expensive to maintain if re-assembled.

I am writing to discuss the adverse economic impact Code Section 89 is having on the employees of small businesses, and, why I believe that simplification and revision of Section 89 should be addressed.

As a Trust Officer specializing in Employee Benefits, my responsibilities include that of working with small businesses, those that employ an average of 25 employees (range 5 to 50 employees) per group. During 1983 - 1987, many employers were hard hit by the weakness in Wyoming's economy. This caused many employers to reduce employer provided benefits. During 1988, employers once again gained the confidence necessary to increase these benefits. Now, however, because of Section 89, these same employers are in a quandary trying to determine if they will be able to shoulder the added burden created by Section 89.

Many employers, and interestingly enough with the assistance of their employees, are quickly coming to the same conclusion--that their small business does not generate enough income to provide for both the benefit and the added cost of compliance administration. Most groups have decided to terminate their benefit plan and in turn providing a payroll increase to the employee with the prayer that the employee will purchase individual health insurance.

This alternative should have the tax collectors sleeping quite comfortably. Employees of small employers, however, are being prevented from participating in the pre-tax benefits readily available to the employees of large corporations. The employees I talk with realize that employer provided health insurance is expensive. In recognizing this, the employee has expressed a willingness to participate with these premium payments. However, when a small employer is economically prevented to provide benefits by the very regulations, that is suppose to be helping his employees, the regulations are missing their objective. The goal to eliminate discrimination is NOT achieved.

Rather, the discrimination shifts from between key/non-key employee to employees of large employers, who are able to have health insurance provided on a pre-tax basis, versus the employee of the small employer where the cost of compliance causes the employer to not maintain a pre-tax health insurance plan. Who suffers? The employee that must not only provide for insurance on an after-tax basis, but who must also purchase health insurance on a higher premium non-group basis.

To illustrate the significance of the added cost associated with Section 89, I provide the following situation: One five employee group was told by their insurance provider that the set-up fee for Section 89 Testing was $2,800.00. Additionally, the employer was to be charged a monthly maintenance fee of $10.00 per participant per month. Total first year cost = $3,400. Annual Group Insurance Premium = $8,220.00. Percentage increase = 42%.

From our experience with a 100 employee group, the associated costs on a percentage basis is not as dramatic, however, is still expensive:

Written Plan Document Requirement:	$ 1,200.00
Notification of Employee Requirement:	
Summary Plan Description (100 employees X $5.00 per booklet)	$500.00
Group Employee Meeting (100 Employees X 1 Hour)	
Employee Registration officer meeting individually with each employee (100 X 1/2 hr. per employee)	

Compliance Testing Requirement:	
Computer program to administer Section 89	8,000.00
Monthly Program Maintenance	260.00
New payroll package program: needed in order to properly account for pre-tax/after-tax deductions	$ 795.00

Added Employee time assoc. directly to S 89:
(50 pay periods X additional 2 hrs per payroll)

Reporting Requirements - Filing 5500:

Data Gathering	4 hours
Preparation and Review	4 hours

Added First Year Cost:	Direct Funds Expended:	$13,815.00*
	(Cost Per Employee = $ 138.15)	
	Direct Time Expended:	258 Hours*
Annual Maintenance:	Direct Funds Expended:	$ 4,120.00*
	Employee Time:	150 Hours*

* Does not include research and preparation time and expense.

Additionally, Section 89 needs to address what I believe is referred to as the "Stupid Employee Rule." Some employees want cash, and they want it now. No Benefits, No Retirement Savings. Nothing. If benefits are offered, the employee doesn't want them. For some employers, the "Stupid Employee(s)" are/will cause a plan to fail the testing requirements. I believe that this type of situation should NOT be allowed to happen. If an employee wishes to elect out of plan participation, even though it is to their economic detriment, then their failure to participate should not cause the balance of employees to suffer the same faith as the "Stupid Employee." In order to enact this, the employer should be allowed to receive a signed waiver from the employee addressing the employee's right not to participate.

Because of the above, I would like to suggest, that the enactment date of Section 89 be postponed until such time that provisions can be included in the regulations that help the employees of the small business.

Sincerely,

Mike Robert Romanyenko
Trust Officer

MONTE L. McNAMEE
CERTIFIED PUBLIC ACCOUNTANT

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS • WYOMING SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

Honorable Senator Malcom Wallop
U.S. Senate Building
Washington, DC 20510

Senator Wallop,

I am writing in regards to the pending legislation regarding Internal Revenue Code Section 89 Rules and the resulting burden that it will place on small business owners in Wyoming and the rest of the nation.

By the inclusion of health and accident plans in the scope of these regulation the IRS, I believe, has effectively eliminated any incentive for a small employer to provide any type of insurance coverage for their employees because of the inordinate amount of regulations and required additional filings that are mandated by these regulations.

In addition to the "legally enforceable" written plan document containing the "material terms and conditions" of the plan, the employer must give employees reasonable notice including "directions on how to receive additional information" the plans must be held for the "exclusive benefit" of the employees. In addition to the above, these small businesses must now file IRS Form 5500's for these "employee benefit" plans, at the cost of the employer, all so that the employer can deduct up to 25% of the cost for their own insurance policy.

You can imagine the additional headache and confusion this will cause the average Mom and Pop and sole proprietor business that makeup the backbone of the American Free-enterprise system that is the hallmark of America.

Finally, if the above was not enough, the plans that are retained are presumed to be in non-compliance, or GUILTY, until they are proven to be innocent. One does not have to be a legal expert to realize that there is something fundamentally wrong with this approach to governing.

I would hope that you would do your best to repel this obviously misguided attempt to this matter.

Respectfully,

Mont McNam

Monte L McNamee

CONVERSE COUNTY MEMORIAL HOSPITAL
111 S. 5th Street
Douglas, Wyoming 82633
307-358-2122

Paul A. Balerud
Administrator

April 7, 1989

Senator Malcolm Wallop
U.S. Senate Building
Washington D.C. 20510

Dear Senator Wallop:

Converse County Memorial Hospital is concerned with the impact of Section 89 on small rural hospitals. The expense of finding and then hiring a knowledgable professional to determine if our plans meet Federal requirements could ultimately result in the loss of employee benefits, even for hospitals that are more than likely in compliance with Federal requirements.

It appears that just because some employees choose not to participate in an employee benefit plan, lowering the percentage of participation below 80%, employees that do participate in those worthwhile benefits could be penalized.

Converse County Memorial Hospital urges you to reevaluate the impact of this legislation on the already foundering Health Care Industry of Rural America.

Sincerely,

Paul A Balerud

Paul A. Balerud
Administrator

PAB/sdk

OFFICE OF THE SUPERINTENDENT

School District No. 1

815 Hamilton
Douglas, Wyoming 82633

MILLARD L MEREDITH
SUPERINTENDENT OF SCHOOLS

DR. JEFFREY JACOBSON
DIRECTOR OF INSTRUCTION

April 7, 1989

The Honorable Malcolm Wallop
United States Senate
Washington, D.C. 20510

Dear Senator Wallop:

We are writing this letter to express our concern over the negative effects of Section 89 on Converse County School District #1 and all the public schools in Wyoming. There are problem areas that must be addressed in order for schools to comply with this new legislation,and frankly, during this time of declining revenues, our money should be spent on children instead of Section 89 compliance.

Converse County School District #1 has been providing equal insurance benefits to its employees regardless of salary amounts for about fifteen years for employees over 35 hours per week. However, Section 89 requires that we gather mounds of information on every employee and test for equality of benefits. The labor cost of gathering all the information is the first burden upon the school district. We have had numerous insurance, accounting and private consultant firms and computer software sales companies contacting our office wanting to do the compliance testing for the district, at costs ranging from $3,000 up to $9,000. All of this money will be spent to inform us that we provide equal benefits regardless of salary, which is something we already know.

If the new legislation requires us to provide all employees working 17 1/2 hours per week with insurance benefits, the school district will have to cut a number of educational programs to pay for these benefits. The district will also consider no longer providing insurance for its employees or cutting all part time employees to 17 hours per week.

We have attempted to obtain guidelines from governmental agencies on Section 89 but have been unsuccessful. The district does not wish to spend tax dollars on more labor, software or consultants until we are certain of the law. Complying with Section 89 with its current timeline is very difficult without written guidelines from its originators.

Senator Malcolm Wallop
April 7, 1989
Page 2

Please take another look at Section 89 and consider the adverse effects of the law. Section 89 will cause additional tax payers dollars going toward compliance instead of education. Section 89 will cause employees to suffer loss of their insurance benefits or reduction in hours because employers cannot afford the cost. Surely this was not the intent of Congress upon its constituents.

Sincerely,

Millard I. Meredith

Millard I. Meredith
Superintendent of Schools

MIM/lat

STOCKHILL'S INCOME TAX ACCOUNTING
AND COMPUTER DATA SERVICES
1814 Sheridan Avenue
CODY, WYOMING 82414
Telephone (307) 587-2234

April 6, 1989

Honorable Senator Wallop,

I am writing to you concerning the new tax laws in general, but primarily Code Section 89 of the Internal Revenue Service. I am presently, and have been a tax preparer in Cody, Wyoming for over 30 years. As you might imagine, I have seen and been through many changes. The business clients that are my clientel are the employers who hire from zero to fifteen employees. I feel that I am writing on their behalf. I also believe this type and size of clientel makes up about 90 percent of the total business people of the United States.

I can verify at the present time three of my clients who have notified their employees to look for new health insurance programs because they are dropping this employee benefit. They have asked for my opinion of this new requirement under Code Section 89, and I advised them to drop any plans or benefits that would fall under the guidelines of Code Section 89. I have three reasons for this advice:

(1) Record keeping requirements are too cumberson and costly
(2) The atrocious penalties the IRS hands out for noncompliance
(3) Most of my type of clients cannot afford the extra burden at this time. In my opinion, the best thing to do at this time is drop all employee benefit plans.

I do not know if you have really tried to analyze what the new tax laws are all about, in particular Section 89. Have you ever asked yourself if these laws are really necessary? Is there any chance of these new laws accomlishing what they are meant to do, or will they work in reverse?

I would like to give you some of my viewpoints and would hope you would take time to think about them. I do not believe there is any possible way to enforce equality in the new laws. I would challenge you to give an assignment to one of your aids to do.

There are probably at least 40 or 50 highly thought of income tax computer software programs in the United States. These programs are all written by very knowledgeable income tax people. I would give you a tax of medium complexity and ask you to take it to 20 of the best preparers of your choice that are using software programs and you may not get the same result twice. If these people cannot agree, how do you think auditors can be trained so that there is any degree of equality for the United States citizen. When laws are made so complicated that even employees of the IRS can't give you the same answer from two different people, then something is going wrong.

robirds
&
associates, p.c. CERTIFIED PUBLIC ACCOUNTANTS

Harold Robirds, CPA
Donald M Robirds, CPA

P.O. BOX 982 – 339 EAST FIRST – POWELL, WYOMING 82435
307-754-5126

April 6, 1989

Senator Malcolm Wallop
The United States Senate
Washington, D.C. 20510

Reference to Internal Revenue Code Section 89

Dear Senator Wallop:

Compliance with Internal Revenue Code Section 89 will be a most difficult task for all businesses that maintain any type of employee benefit plan. Because of the difficulty that will be encountered in attempting to comply with the requirements of Section 89, many small businesses will eliminate plans now in effect. Most small businesses will not be able to comply without professional assistance. The problems created by the law far outweigh any benefits gained for the employee. When the IRS needs 154 pages to list rules they claim would relieve employer's worries about regulatory overkill, the law should be repealed.

An article in the April issue of Nation's Business very adequately sums up the complications and the real affect of this law. The article begins on page 65, continuing on page 66, with an interview with one of the co-authors of Section 89. Please take time to review this article.

Sincerely,

Harold Robirds

Harold Robirds
Certified Public Accountant

HR/m

GENERAL CONTRACTORS

CASPER
PHONE (307) 234-4898

THATCHER & SONS

GLENROCK
PHONE (307) 436-2269

P. O. BOX 700
GLENROCK, WYOMING 82637

April 6, 1989

The Honorable Malcolm Wallop
United States Senator
204 Russell Senate Office Building
Washington, D.C. 20510

Senator Wallop:

It has come to my attention that a special hearing is to be held on April 13 to review Internal Revenue Code Section 89 and it's corresponding procedures, regulations and concepts.

I greatly appreciate your concern in reference to this law. As an officer, stockholder and employee of a small business corporation, I can unequivocally state that this law is very negative and detrimental to our business operations.

We are a moderate sized firm who has billings in excess of $1.3 million and payroll in excess of $400,000.

I have reviewed Internal Revenue Code Section 89 with my accountant, attorney and insurance agent. The negative aspects of this law are overwhelming:

Our corporate structure has concluded that it would be most advantageous to totally delete all fringe benefits which are within the parameters of Internal Revenue Code Section 89. We regret having to take this action; however, we feel compelled to pursue this alternative due to:

1. Reporting requirements.
2. Cost of maintaining plans and compliance with the new Code Section.
3. Ambiguity of the law.
4. Proposed penalties for noncompliance. I have a question in this regard: Why is the Treasury Department, the Internal Revenue Service and the administrative branch of our government so willingly and willfully imposing penalties? If an error is made by the Treasury Department and/or Internal Revenue Service, no penalty is reimbursed to the taxpayer; however, when the taxpayer makes an error, penalties plus interest are assessed, both compounding daily. Is this FAIR AND EQUITABLE?

The Honorable Malcolm Wallop
April 6, 1989 - Page 2

I would appreciate your continued support of total repeal of Internal Revenue Code Section 89 and other similar Code Sections which implement undue burden upon small business and all taxpayers in general.

If the law is enacted, many employees of our firm will be without medical benefits and other associated benefits. This is very detrimental to these employees and their families. However, the costs of maintaining such benefits are not "economically feasible" in light of the business atmosphere in Wyoming at this time.

Sincerely,

LaVerna Hendricks

LaVerna Hendricks
Secretary-Treasurer
THATCHER & SONS, INC.

lfh/bjr

LENHART
FERGUSON
& COMPANY

Certified Public Accountants *Members: American Institute of Certified Public Accountants • Wyoming Society of Certified Public Accountants*

Douglas L. Ferguson, CPA *Jack E. Lenhart, CPA* *Richard J. Bratton, CPA*

April 6, 1989

Honorable Malcolm Wallop
United States Senate
204 Russell Senate Office Building
Washington, D. C. 20510

Dear Senator:

We are nearing the end of yet another tax season with, again, many mixed emotions. As accountants, we must be somewhat thankful for the revenues the first three and one-half months generate, but at the same time must wonder how a more voluminous, ambiguous and confusing tax code can be associated with "simplicity". To our best abilities, we attempt to pacify taxpayers and help them understand their tax ramifications. To be honest with you, it is becoming an increasingly difficult, and at times, impossible job.

Time is valuable for all of us, but we must again present both our clients' and own view on the requirements of IRS Code Section 89. Our firm's client base is made up mostly of small businessmen, as is probably the case for most of Wyoming. Economic conditions in other areas of the Country may be strong, but the small businessman in Wyoming is using all of his mental and physical resources to survive. Many hurdles have to be overcome daily, including changes in the tax code. If the taxpayers understand the intent of the law, they can accept the changes. With so many of the current employees working part-time, the implementation of Section 89 puts the employers in a difficult situation. The employer cannot afford to pay full benefits, but at the same time, does not want to lay off part-time employees either. In addition, the administrative time and cost would put many businessmen in a difficult economic situation, making compliance prohibitive.

We continue to support your position attempting to repeal Section 89 requirements, especially for the small businessman.

Thank you for your consideration and continued support.

Respectfully,

Dick Bratton

Richard J. Bratton, CPA

RJB/tsp

139 West 2nd Street, Suite 1C, Casper, Wyoming 82601

El Jarro Family Restaurants

Sombrero Inc.
500 West F
Casper, Wyoming 82601

El Jarro Family Restaurants, Inc.
2807 CY Ave.
Casper, Wyoming 82604

April 7, 1989

Senator Malcolm Wallop
United States Senate
204 Russell Senate Office Building
Washington, D. C. 20510

Dear Senator Wallop:

Both my Certified Public Accountant and my insurance carrier have recently provided me with information regarding Federal non-discrimination tests for employees. It appears to be another means in which the Federal Government is interfering with the operations of my business. I operate a family restaurant and employ many part-time employees. Many of these employees work a wide range of hours depending on many circumstances. Many are either college or high school students. Many are spouse's trying to supplement family income.

I reviewed a copy of my March 18, 1989 payroll to see how Section 89 might affect me. For the two-week period, I paid 73 employees who worked a total of 3,302 hours. I am open six days per week, which means each employee worked an average of three and three-fourths hours per day. During this two-week period, one employee worked 114 hours and a couple only worked five hours each. I believe I treat my employees fairly and I think they would agree. I do my best to accept and meet the needs of their schedules. If I must begin to keep track of each employee's weekly hours, seasonal coming and going, and the other criteria listed in the information I received, I know who will be the losers; the part-time employees who need the wages not health insurance, life insurance or child care coverage.

I understand you are in favor of repealing some of these requirements which, if not repealed, would put the small businessman in a tough situation. I support your position and hope Congress can come to a fair and reasonable decision.

Respectfully yours,

Fred C. Christman

Fred C, Christman, President

Porter Muirhead & Co.
Certified Public Accountants
123 West First Street, Suite 690 Box 2673 Casper, Wyoming 82602 (307) 265-4311

April 6, 1989

The Honorable Malcolm Wallop
United States Senate
Washington, D.C. 20510

Dear Senator Wallop:

I am prompted to write because I understand that Congressional hearings will be held soon to discuss the impact that Internal Revenue Code Section 89 is having on the workplace. It is important for you and your colleagues to know that the impact these rules are having is anything but positive.

As a practicing CPA, I am in touch with a number of small businesses located throughout Wyoming. In discussions with friends and clients, it is apparent that these new rules are considered unproductive. There are many small employers who are throwing up their hands in disgust and considering terminating current health and accident plans provided to their employees. The compliance and testing requirements are leading many to believe that these new rules are another government imposed waste of time.

I encourage you to pound reason and common sense into your fellow Congressmen and have the Section 89 rules deleted. How will you explain to the employee in Wyoming who loses his health coverage that this is part of a bigger plan and for his own good? This country needs to become productive, producing materials for consumption, not pushing papers.

Very truly yours,

T. Chris Muirhead, CPA

sp

Wyoming State Legislature
213 Capitol Building / Cheyenne, Wyoming 82002 / Telephone 307/777-7881

REPRESENTATIVE GAIL ZIMMERMAN
Natrona County
2361 Trojan Drive
Casper, Wyoming 82609
Committees:
Revenue
Education

Casper, Wyoming
April 6, 1989

The Honorable Malcolm Wallop
United States Senator
204 Russell Senate Office Building
Washington, D. C. 20510

Dear Senator Wallop:

The special hearing to be held on April 13 to review Internal Revenue Code Section 89 is of vital importance to the Small Businesses in Wyoming. It is my fervent hope that the result of this hearing will be the repeal of this entire section.

The Wyoming Legislature attempted to address the problems associated with maintaining a small business in the State of Wyoming given the current recession. Our efforts were not totally satisfactory. Link deposits and loan guarantee programs even though attractive cannot overcome oppressive regulation.

The net effect of Section 89 would be to deny to all employees of small businesses within Wyoming the fringe benefits they need and deserve. The reporting requirements are horrendous. I think a good investment would be to purchase stock in a paper company and one which prints forms for tax reporting.

Please give your every effort to the total repeal of this section of the IRS code.

Sincerely,

Gail D. Zimmerman

Gail D. Zimmerman

GERALD T. STACK & ASSOCIATES, PC
CERTIFIED PUBLIC ACCOUNTANTS

SUITE 400-30
123 WEST FIRST STREET
CASPER, WYOMING 82601

TELEPHONE:
307/265-3400

April 7, 1989

The Honorable Malcolm Wallop
U.S. Senate
Washington, D.C. 20510

Dear Mr. Wallop:

As an experienced tax practitioner, I am writing to express my belief that Internal Revenue Code Section 89, which deals with nondiscrimination rules for employer provided fringe benefits, should be repealed.

In my professional judgment, IRC Section 89 is poor tax policy and poor social policy. This statute is unworkable from a technical standpoint, and is so potentially punitive that many employers will choose to simply reduce or eliminate essential employee benefits such as health insurance rather that face the high costs of compliance and continuous exposure to substantial IRS penalties. Section 89 thus conflicts directly with the goal of Congress to expand health coverage in the U.S.

I urge you to support current efforts in the Senate to delay the effective date of Section 89 and to fully support its repeal when legislation to do so is introduced. The people of Wyoming have a right to employer provided fringe benefits. Please support efforts to keep them in place.

Very truly yours,

Gerald T. Stack, CPA

Gerald T. Stack, CPA
Gerald T. Stack & Associates, CPA's, PC

robirds
&
associates, p.c. CERTIFIED PUBLIC ACCOUNTANTS

Harold Robirds, CPA
Donald M Robirds, CPA

P.O. BOX 1600 · 1526 BECK AVENUE · CODY, WYOMING 82414
307-587-4224

April 5, 1989

The Honorable Senator Malcom Wallop
c/o Larry Bean
P. O. Box 3732
Casper, WY 82602

Dear Senator Wallop:

I am writing to express my concerns on Code Section 89.

The first question I would ask, why was this law needed? The businesses we deal with in Wyoming primarily cover their employees with these types of fringe benefit plans so I believe the thrust of the law, under Code Section 89 is redundant.

The second question, with the added recordkeeping requirements, confusion, and additional expenses incurred, it is my belief that most small businesses will drop these fringe benefit plans rather than trying to understand the complicated compilance struture as was addressed. The general attitude of clients is, why bother with all of the additional paper work when we can merely drop all the plans, especially in the medical insurance area, pay personally for our own medical insurance and let all of the employees be liable for their own policies. In so doing, the cost of medical insurance for each individual involved will increase as they will not be able to get group insurance rates and in most cases the amount of coverage and types of coverage will decrease. This also places an additional burden on insurance carriers, as they will have to try to sell individual policies and administer those policies rather than one group policy. This in turn increases their costs and we both know that those costs will be passed on to the insured.

The final question I would like to address is, most of the businesses in Wyoming are suffering from economic conditions and Code Section 89 adds to their financial hardships. If they choose to try to comply with the law and maintain their existing fringe benefit programs, there will be a considerable amount of additional cost incurred by their accountant, by their attorney and also by the insurance companies. These additional costs will pass on and certainly be an additional hardship to these individual companies.

If Code Section 89 is allowed to remain as presently written and employers discontinue their fringe benefits, I believe this would be another step for the Government to try to pass a mandatory national health insurance policy to be born by the employer. This I am admendantly opposed to, as I certainly feel it would drive many small businesses out of business in today's economic enviroment and Wyoming can ill afford to lose our small businesess. The small businesses need tax incentatives rather than additional cost to bear.

I sincerely support your stance on this bill and you certainly have my appreciation for your work in this area.

Sincerely yours,

ROBIRDS AND ASSOCIATES, P.C.

Donald Robirds

Donald M. Robirds
Certified Public Accountant

DMR:ps

David J. Kreycik
Certified Public Accountant

Box 1043 • 315 E. Walnut • Douglas, Wyoming 82633 • 307/358-3933

Honorable Senator Malcolm Wallop
U.S. Senate Building
Washington, DC 20510

Senator Wallop:

I urge you to do whatever you can to modify or repeal revenue code section 89. The effect will be devastating to the small businessman. Section 89 is very complicated, difficult to understand, and expensive to comply with. I fear it will cause many small businessmen to quit supplying any coverage for their employees. Many of their plans are discriminatory now and rather than comply it will be easier to cancel them. If congress is to retain section 89 there must be some relief for the small business employer.

An example is a small family ranching corporation where mom and dad wish to provide insurance for their sons and daughters who work on the ranch but find it to expensive to provide coverage for the other six employees. This family must now test their plan and possibly rewrite it, inform all of their employees, then make a decision. They have to decide whether to provide medical insurance to all of their employees, none of their employees, or tax excess benefits to their family members. I am not sure they can do this without expensive professional assistance.

There must be some relief for the small businessman. Section 89 is difficult for professionals to understand and impossible for the small businessman to understand. It needs to be simplified or needs to exclude the small businessman. I urge you to do what you can to help us.

Respectfully,

David J. Kreycik

David J. Kreycik
DJK/tku

CIMN CHEYENNE INTERNAL MEDICINE AND NEUROLOGY P.C.
800 East 20th Street, Suites 205-206
Cheyenne, WY 82001
(307) 634-1311

Robert R. Kanard, M.D.
Philip M. Sharp, M.D.
Earl W. Robison, M.D.
Peter G. Perakos, M.D.

Reed C. Shafer, M.D.
Roy A. Kanter, M.D.
Andrea C. Adams, M.D.

1988 JUL 5 AM 11: 25

June 30, 1988

The Honorable Malcolm Wallop
210 Russell Senate Bldg.
Washington, DC 20510

Dear Senator Wallop:

I am a small business owner. I've recently learned that Congress passed new rules in the Tax Reform Act that may affect the health benefit plan I provide my 30 employees. These new rules, referred to as "Section 89," are effective January 1, 1989. These rules are difficult even for benefit experts to understand. This new law may increase my taxes unless a certain number of my employees choose to take the health plan.

I'm writing to ask that you work for a delay of these rules so there is time to simplify them for small businesses like mine. Small businesses that offer health benefits should not be penalized by complicated and burdensome rules. Please reply with your views on the need for simplification of this law for small businesses.

Sincerely,

Philip Sharp MD

Philip M. Sharp, M.D.
800 E. 20th St.
Cheyenne, WY 82001

PMS/lmh

STATEMENT OF SENATOR JOHN KERRY ON SECTION 89

Mr. Chairman, yesterday the Senate, in response to an overwhelming outcry from the small business community, unanimously expressed its sense that section 89 of the Internal Revenue Code of 1986 "imposes an intolerable and unjustified burden of compliance upon employers". In addition, we requested that the House immediately adopt and send to the Senate for consideration a bill to "repeal or to modify substantially" section 89.

I supported this measure because section 89, if implemented in its current form, would not produce the results for which it was intended -- that being the fair and equitable distribution of employee health benefits. In fact, the law as enacted in the 1986 Tax Reform Act, might actually offer small business owners little choice other than to cut back the benefits which they offer their employees. It is clear then that requiring businesses to conform to section 89, in its current form, is a bad idea.

However, the spirit and intent behind section 89 is a good idea. I do not believe that the federal government should allow businesses a deduction for the expense of providing benefits unless those benefits are extended in a nondiscriminatory fashion.

We on Capital Hill are often reminded, rather loudly, when our policies are going to cost business money. I think that businesses should remain acutely aware that tax-favored treatment for employer provided benefits costs the government money. And that Congress explicitly justified that cost if "such benefits fulfill important social objectives, such as increasing health insurance coverage among taxpayers who are not highly compensated and who otherwise would not purchase or could nor afford such coverage."

Mr. Chairman I look forward to today's proceedings on Section 89 of the Internal Revenue Code. It is my hope that through testimony offered today, and testimony to be offered at hearings scheduled by other committees in the future, we in Congress might gain a more thorough understanding of how to implement the spirit and intent of section 89, without imposing an excessive administrative burden on small businesses.

U.S. SENATOR
Don Nickles
OKLAHOMA

STATEMENT OF SENATOR DON NICKLES
SENATE COMMITTEE ON SMALL BUSINESS

SECTION 89 OF THE INTERNAL REVENUE CODE

APRIL 13, 1989

Mr. Chairman, I thank the Committee for allowing me to testify today on one of the most burdensome compilations of the Internal Revenue Code affecting businesses - large and small - throughout the nation. Section 89 is a confusing, confounding mass of regulatory jargon that requires every employer to micro-analyze his or her current employee benefit plans in search of 'benefit discrimination'.

Section 89 requires all business owners to examine the distribution of their benefit plans among their high-level and rank-and-file employees. Employers would then be mandated by law to provide insurance benefits for any employees who work as little as 17-1/2 hours per week. This new provision is blatantly unfair and meddlesome, and will negatively impact business owners and their employees, not to mention the economy.

Yesterday, the Senate voted unanimously in support of a resolution I joined in sponsoring which called for the repeal or delay of Section 89. Fifty-six senators supported an amendment I joined in sponsoring to immediately delay Section 89's implementation until January of next year, giving the House Ways and Means and the Senate Finance Committee time to revisit this ill-conceived requirement.

Given this show of support in the Senate, it is my hope Congress will move rapidly in correcting the significant flaws created by this law. I would urge members of the committee and others interested in the issue to consider S. 350, legislation I introduced with Senator Lott on February 7 which would repeal Section 89.

Section 89 is a businessman's nightmare. It is full of so many complicated eligibility tests and so many restrictions, that it took the experts at the Internal Revenue Service more than two years to figure out the guidelines.

The IRS guidelines were to be ready for the public by November 1988. It was not until March 1989 that the IRS finally released the guidelines for Section 89 -- three months after the law already took effect.

How can we expect U.S. businessmen and women to understand the kind of benefits they need to be providing their employees when the IRS is having trouble figuring out the guidelines themselves? Tax attorneys and accountants are warming up their adding machines in anticipation of all the new business.

The costly data-gathering requirements and complicated valuation rules to test the eligibility and benefit provisions of each plan are so burdensome that I'm afraid Section 89 will not be fulfilling its intended purpose to provide employees with fair, and in many cases, increased benefits. I'm afraid Section 89 will have the opposite effect.

Those firms that do not now offer health benefits will be further discouraged to do so. And those businesses that do provide health benefit plans will be inclined to reduce the benefits (eliminate dependent coverage, for example) or terminate their plans altogether.

Section 89 is simply a bad law that ought to be repealed or rewritten to best suit the needs of both the employer and the employee. As it stands now, Section 89 is of no value to either party. It has a stifling effect on our nation's business sector, and jeopardizes many employees' existing benefits.

I am delighted to see that my good friend, Terry Neese, a fellow Oklahoman and outstanding businesswoman, is also here to testify about the devastating effects of Section 89. Our nation's economic growth depends on the kind of enterprising talent that Terry has showed in her own business. The last thing our business community needs is a misguided and poorly constructed piece of regulatory language.

Government involvement in business, when not properly monitored, can undermine and destroy the basic foundations of a free economy. I will continue to work toward the preservation of a business environment free from unnecessary regulatory burdens. Thank you, Mr. Chairman.

STATEMENT OF PETE V. DOMENICI
BEFORE THE SENATE COMMITTEE ON
SMALL BUSINESS ON SECTION 89

APRIL 13, 1989

Mr. Chairman and members of the Committee, I want to thank you for this opportunity to share my views with you today. First, I want to take a moment to describe some of the specific problems pertaining to Section 89 the small business people in my state have relayed to me. Also, I would like to make a brief statement about my bill, S. 595, the "Section 89 Small Business Relief Act of 1989."

Section 89 was enacted as part of the Tax Reform Act of 1986. With few exceptions, this law requires all employers who offer benefit plans to conduct a series of complex statistical tests to ensure these plans are distributed fairly among the highly compensated employees and average, rank and file workers.

Mr. Chairman, with 25 million uninsured workers and workers' families in this country, encouraging private insurance coverage is a worthwhile goal. I don't think there is anyone here who would disagree with the intent of Section 89. The problem is that small businesses, benefits experts, accountants, and attorneys are all finding they can't figure out the rules necessary to comply with the new law.

The IRS issued regulations to implement Section 89 on March 2 --- 200 pages of rules for the business people of this country to grapple with. But, 200 pages of rules, confusing as they may be, is nothing compared to the confusion caused by the statute itself.

I applaud the IRS's efforts to clarify the law, and from what I understand, additional guidance regulations are forthcoming. These rules will extend the date that employers must notify employees of the benfits available to them from January 1, 1989 until July 1, 1989. Also, the the regulations add additional alternative testing procedures and a new test.

As I said, I admire the IRS's efforts to clarify this monster known as Section 89. However, these regulations only touch the surface of the complex issues surrounding this new law. The regulations leave out some very important issues which must be addressed. Some of these areas include: multiemployer plans, separate line of business rules, group term life insurance rules, the treatment of former employees, definitions of excludable employees, and the treatment of leased employees.

I will not go into the other changes the regulations make at this time. However, I must say that since the thrust of the law is still intact, I do not believe these regulations will do much to aid compliance significantly. At best, they leave many unanswered questions and raise new problems for employers who are making decisions concerning employee benefit plans.

I have spoken with several small business owners in my state and also some small business groups here in Washington and the consensus seems to be clear---Congress should be focusing its efforts on the REAL problem, and that is Section 89 itself.

Today I have brought some of the letters I've received from the small business people in New Mexico and elsewhere in the United States. I would like to submit them for the record. It seems there are two types of letters. Some business people say they are aware of Section 89 and they are flabergasted and outraged. Others aren't even aware of the law or its ramifications. Mr. Chairman, it is these letters that worry me most.

One small businessman said that he had studied the meaning of the law very carefully and decided the best way for his business to cope would be to drop their company sponsored health plan and raise everyone's salary by $100 a month. Then, they would allow the employees to decide for themselves whether or not they want to purchase their own coverage or, as this businessman put it, "spend the extra $100 on beer."

Another small businessman told me "we know we'd pass the tests, but it would cost thousands of dollars and thousands of wasted man hours just to prove it."

One small business woman wrote "we have elected to let sleeping dogs lie. We will not be following through on plans to offer group insurance to our employees. We are very disappointed to have to make that decision. It was a service we wanted to provide."

These comments may sound extreme, but they are comments I have heard over and over again. They provide a very accurate illustration of the frustration employers in this country feel.

Mr. Chairman, Section 89 is poor policy, by anyone's judgement. Most small businesses already offer comprehensive benefit plans and instead of encouraging this, Section 89 serves as a hindrance. The requirements of this law place an unfair burden on all businesses, but especially small businesses because they don't have the resources to deal with the paperwork and compliance issues.

I am aware of an analysis prepared by OMB that estimates it will take approximately 10 hours per firm to comply with Section 89. From what I have heard from the business people in my state, this estimate is ludicrous. It will take more time than that for them to just read through and understand the 200 pages of regulations, much less collect the necessary data, and perform the testing computations.

I, along with many of my colleagues in the Senate and the House, are concerned that Section 89---even with the regulations---will achieve the opposite effect of what it was intended to do. Employers will be forced to spend exorbitant amounts of money to comply with the law. This is money that they would rather spend on benefits for their employees.

I think the willingness of the IRS to delay the effective date of the law, and the impending penalties, is testament to the fact that the law is flawed. There are many in Congress who would like to scrap the entire law and start from scratch. I am not willing to go to that extreme.

In 1987 88% of all businesses in my state had fewer than 20 employees. Thus, legislation directed at expanding coverage for the working uninsured must focus on the small business sector because in large part, that is where the problem is most pervasive.

The bill that I have introduced proposes some very basic changes that will help relieve the burden of this law on small businesses. Briefly I would like to tell the Committee members about my bill. S.595 would make the following changes:

1. Exempt all small businesses consisting of fewer than 20 employees from Section 89 altogether;

2. delay the effects of the law for two years;

3. implement a 25 hour standard for part-time employees;

4. provide that employers who offer benefits to all employees are in compliance with the law regardless of whether or not the employee chooses to participate in the benefit package.

I would like to stress that S. 595 is not intended to be final solution to this problem, but it is a starting point for discussion.

Mr. Chairman, I would like to thank you and the members of this committee for giving me this time to voice my concerns about Section 89. I will look forward to working with my colleagues to restore fairness to the law.

January 31, 1989

The Honorable Pete Domenici
U.S. Senate
Washington, DC 20510

In regard to the IRS Section 89 rules, I have spent two days trying to understand the requirements and comply with this new rule. At this point I can only ask for your help in eliminating this additional burden. Small business owners are already inundated with countless Government forms and paperwork. In the operation of two small businesses employing approximately 100 people I currently spend 2 days per week average in complying with "COBRA", "ERISA", "IRS" and many other State and Federal rules. Now comes "Section 89". If this burden cannot be repealed then please help me to understand and comply. I do not understand how to even begin. I have a small Guard Contract at White Sands Missile Range with approximately 84 personnel. There are two owners who would be included in "HCE" (page 1 attachment). This work force is covered with a Collective Bargaining Agreement. Only full time personel are covered for health benefits which the company pays 100%. Fulltime personel dependent coverage is co-insured 80% paid by company and 20% paid by employee. There are 55 full time employees currently on the payroll. Part-time personel can participate if they pay for the coverage themselves and their dependents. The part-time work force presently numbers 20.

Full-time and part-time catagories are as defined in the

Collective Bargaining Agreement.

There are in addition to the above, nine supervisory personel for which the company pays both the employee and dependent coverage 100%.

The same percentages and number of personel apply to the Dental Plan, Vision Plan, and Group life insurance.

To help you help me, I've provided you with a copy of the Section 89 Rules. (see attached)

The second business is a retail furniture store which employees 15 to 20 personel. I have had a health plan for these employees for the last six years. With Section 89 I feel it would be much simpler to cancel the health plan. This would also save 2000.00 per month. It is also impossible to comply with Section 89 in the absence of regulations.

As described in attachment this new law can only be described as outrageous, costly, complex, confusing, and counterproductive. It is time for all law makers to realize that small employers must have help. Everyone must remember that before the employee can get paid, or have paid benefits, the employer must have the money.

Please , please help us.

Jerry Fambrough

Jerry L. Fambrough
President
SERCO INC.

NATIONAL HOME
FURNISHINGS ASSOCIATION

P.O. Box 2396, High Point, NC 27261 • (919) 883-1650 • 800-621-9823 • FAX (919) 883-1195

January 12, 1989

The Honorable Pete V. Domenici
United States Senate
Washington, DC 20510

Dear Senator Domenici:

On behalf of the National Home Furnishings Association (NHFA), we urge you to begin the 101st Congress by moving quickly to avert a serious problem for retailers. Specifically, we urge you to halt implementation of Internal Revenue Code Section 89. NHFA represents the home furnishings retail industry.

Section 89 was enacted as part of the Tax Reform Act of 1986 to "encourage" employers to provide certain benefits, such as medical insurance, to all employees equally regardless of compensation level, if they are offered to any employee. The heart of Section 89 is a complex scheme that requires employers to apply a number of tests to their benefits to determine whether benefits are provided on a non-discriminatory basis. If the benefit plans fail the tests, both the employer and employees who receive the "excess" benefits, face stiff tax penalties. Despite changes made to the law in 1988, and a two-year lead time, even the IRS was unable to come up with adequate comprehensive guidance before the effective date.

In the absence of regulations, it is absurd to expect businesses to comply with this law. At a minimum, defer compliance and enforcement for at least one year. We believe, however, repeal would be the better course of action. It is time we started thinking about giving small business owners a little more time to do business, rather than filling their days with non-productive, excessive paperwork.

We look forward to working with you in the 101st Congress.

Sincerely,

David Schmitt

David Schmitt
Executive Vice President

DS/cab

Affiliates: Interior Design Society • Southern Home Furnishings Association • NHFA-Mass • Midwest Home Furnishings Association • Florida Furniture Dealers Association • Rocky Mountain Home Furnishings Association • Northwest Furniture Retailers Association

CARPETLAND U.S.A.

P.O. Box 3128, 8201 calumet ave., munster, indiana 46321 (219) 836-5555 • (312) 978-6600 • FAX (219) 836-2117

March 17, 1989

The Honorable Pete V. Domenici
U.S. Senate
Washington, DC 20510

Dear Senator Domenici:

I am writing to urge you to take action to avert a serious problem for the business community. Specifically, I urge you to halt implementation of Internal Revenue Code Section 89.

Section 89 was enacted as part of the Tax Reform Act of 1986 to encourage employers to provide certain benefits, such as medical insurance, to all employees equally regardless of compensation level, if they are offered to any employee. Despite changes made to the law in 1988, and a two-year lead time, even the IRS was unable to come up with adequate comprehensive guidance before the effective date.

I believe this legislation is an example of good intentions gone awry. It is absurd to expect businesses to comply with Section 89 in the absence of regulations. We do not expect, however, that the regulations will greatly reduce the burden imposed by Section 89. I believe only one solution exists; repeal this onerous law.

Sincerely,

Paul Bumblauskas
Vice President - Finance

PB/ls

cc

National Society of Public Accountants
1010 N. Fairfax Street, Alexandria, Virginia 22314
Tel: (703) 549-6400, FAX: (703) 549-2984

March 1, 1989

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Dear Senator:

On behalf of the 23,000 independent accountant members of the National Society of Public Accountants (NSPA) and their nearly 5 million individual and small business clients, I strongly urge your support of S. 350, as introduced by Senator Trent Lott. This is a significant piece of legislation for small business as it provides for the repeal of Section 89 of the Internal Revenue Code.

Section 89 became effective on January 1, 1989. The provision requires employers to maintain an intricate series of records for their various employee benefit plans. This recordkeeping process attempts to measure whether employer-sponsored benefits are fairly distributed between both higher and lower-paid employees. Nearly every health, accident, and group term life insurance plan may annually be subjected to costly rules and recordkeeping procedures.

As a result, virtually every American employer now faces unavoidable compliance costs, excessive administrative compliance burdens, and looming noncompliance penalties. For employees, they may individually be required to pay taxes on the benefits received should his/her employer fail the compliance tests of Section 89. Although the IRS has yet to release regulations, informal reports suggest that the regulations are likely to be 250 pages in length. As a result of this Code provision, many employers have announced a desire to discontinue their employee benefit plans.

The National Society commends Congress for its interest in a better "quality of life" for all American employees, yet we believe that Section 89 is not the answer. Section 89 provides significant disincentives against maintaining current benefit plans for the employees of a firm.

I urge you to cosponsor S. 350. Thank you for your consideration of this important small business matter.

Sincerely,

Katie Mathes

Katie Mathes
President

BURT, WRIGHT & COMPANY
CERTIFIED PUBLIC ACCOUNTANTS
Financial Consultants

- Dennis R. Burt, C.P.A.
John D. Wright, C.P.A.
C. W. Phillippi, C.P.A.

1989 FEB 16 PM 11: 23

February 13, 1989

The Honorable Peter V. Domenici
SD 434
Dirksen Senate Office Bldg.
Washington, D.C. 210510

Dear Senator Domenici:

As members of the New Mexico Small Business Community and, indeed, as advisors to many other members of the New Mexico Small Business Community, we request your assistance in the delay of implementation or outright repeal of Internal Revenue Code Section 89 (Section 89) relating to nondiscrimination tests for employee benefit plans. At the least, the delay would allow time to study the cost and effect of the law on small business in New Mexico.

The intricate series of quantitative compliance tests for Section 89 are so restrictive and burdensome as to cause small businesses in New Mexico to cancel all employee benefit plans (including health insurance) for their employees.

The discrimination requirements of the law are not the reason for cancelling benefit plans. Most small business owners cover their employees with the same coverage they have for themselves and, in fact, have generally been required to do so since 1982 under The Tax Equity and Fiscal Responsibility Act. The primary reason for cancelling employee benefit plans is the complication and expense of determining if the plan is discriminatory and the penalties that can result if a plan is determined to be discriminatory.

Penalties resulting from a determination that a plan is unqualified relate to benefits received under the plan, not to the tax deduction granted. For example, if an employee incurrs $50,000 in hospital bills, which are paid by the corporate health insurance company under a plan that is determined to be unqualified, the employee must include the $50,000 of benefits paid to the hospital in income instead of the monthly cost of health insurance that was deducted.

Large and national corporations have no problem with the compliance requirements because of the large number of employees and the need to maintain a permanent personnel staff to manage their employee benefit plans. Further, when you spread the compliance costs over 500 or more employees, the cost becomes far less significant than it is for an employer with 25 employees, or worse yet, an employer with 14 employees.

50 or less

505 268-9931

4001 Indian School Road, N.E. • Suite 214 • Albuquerque, NM 87110 • (505) 265-6604

Congress has performed a devastating blow to employers of small business and we urge your support or initiation of legislation to redress this grevious error.

If we can be of assistance to you in addressing this matter, please contact Mr. C. W. (Skip) Phillippi at 505-265-6604.

Sincerely,

C. W. Phillippi, CPA
Tax Partner

sd

LMM LINDELL M. MITCHELL
& ASSOCIATES

5907 Alice NE, Suite F, Albuquerque, New Mexico 87110 / (505) 266-8795 / 1-800-858-2525

February 22, 1989

Senator Pete V. Domenici
434 Dirksen Senate Office Building
Washington D.C. 20510

Dear Senator Domenici,

Enclosed are some articles on Section 89. Many people are still unaware Section 89 exists. If they knew, they would probably come to Washington in a riot! This is the most God-awful legislation the IRS ever perpetrated on us. I know Congress did not have any idea the implications of what you were passing!

The general public is getting fed up with "legislation by the IRS." They have perpetrated disaster upon disaster. It is time you Congressmen became responsible and thought through the legislation before you pass it!

The legislation is a tragedy for the small businessmen. In case you do not know it, it is the small businessmen that provides the extra jobs in the country. I am a small businessman. For the last several years, I have hired, cared for, and been responsible to meet payroll for a handful of people. I am no longer going to maintain any fringe benefit programs because this kind of legislation makes it prohibitive. It is prohibitive for me to spend the time and mental anguish just to worry with it, much less try to figure out how to regulate it when the regulations are not even out yet!

Obviously, the purpose of my letter is to urge you to come to your senses and see to it this legislation is repealed effective retroactively back to January 1. We cannot have this kind of nonsense coming from our government trying to stifle our ingenuity, our innovation, and our creativity when our nation so badly needs it.

Cordially,

Lindell M. Mitchell
Certified Financial Planner

Enclosures

McNeill's Service, Inc.
3620 N. Prince
Clovis, New Mexico 88101
(505) 762-7026

1989 MAR -1 AM 8 59

February 21, 1989

Congressman Pete Domenici
434 Dirkson Bldg.
First & Constitution Ave. N. E.
Washington DC 20510

Dear Congressman:

THANK YOU SO VERY MUCH FOR ALL YOUR EFFORTS IN KEEPING CANNON AIR FORCE BASE HERE IN CLOVIS.

We are also writing you regarding Section 89 of the 1986 Tax Reform Act.

We are extremely disturbed by all the requlations and record keeping requirements of Section 89. We believe that this will be a terrible hardship on small businesses.

We have a heating and air conditioning business that employs only one employee other than my husband and myself. This employee is at this time only part time. We offer a vital service to the community. Vertually all the heating and air conditioning businesses in Clovis are small and there are times when we all become so discouraged by the record keeping requirements that we just want to give up and quit.

We realize that the purpose for Section 89 is to help the working men and women have health insurance, but we work extremely hard for not very much money and we are asked to comply with the same regulations that large companies do.

We feel that this will be very costly for everyone. Big business will just have to raise the price for their products and small business just won't be able to have health insurance anymore.

Please give this some thought and see if there is anything that can be done to change what we feel is a very unfair law.

Thank you very much.

Sincerely,

Jack McNeill
Mrs. Jack McNeill

Mrs. Jack McNeill
Jack McNeill

Publishers Printing Co., INC.
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P.O. Box 37500 • Louisville, Kentucky 40233 U.S.A.

February 28, 1989

Senator Pete V. Domenici
Dirksen Office Building
Suite 434
Washington, DC 20510

Dear Senator Domenici:

Have you read the non-discrimination provisions contained in Section 89 of the revenue code? In my twenty-five years in the business, this is some of the most asinine, complicated, and costly rules to put into effect and monitor I have ever seen. Would you believe our health, life, and accident insurance carriers are telling us that Section 89 is too complicated for them to give us an opinion as to whether we are in compliance with this new law?

I urge you to repeal Section 89 because whatever abuse Section 89 does away with will not compensate for elimination of benefits for a great number of employees who work for smaller companies like us.

In addition, under the 401K provisions of the tax code, we understand that people who make $52,000.00 and above can defer almost none of their income for their retirement unless all other employees do likewise. As employees who make less than $50,000.00 want and need all of their money to live on, they will save very little, if any, of their money through a 401K plan. To penalize people above that income bracket is very unfair and you should at least have a minimum deferral of five percent for everyone regardless of their income bracket, with a cap of $7,500.00 contributed to a plan in any single year. You and I are both keenly aware that any excess social security funds are not being put aside but are being used to cover daily government expenditures and those who can afford it should be putting monies aside for retirement.

If you have any questions or if I can be of any further assistance in this matter, please advise.

Cordially yours,

R.A. Whelan
R. Anthony Whelan
Vice President-Finance

RAW:kg

TELEPHONES: WATS LINE — (800) 626-5801 • LOUISVILLE, KY. — (502) 955-6526 • SHEPHERDSVILLE, KY. — (502) 543-2251

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William P. Farrell
President and CEO

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January 20, 1989

The Honorable Pete V. Domenici
United States Senate
Washington, DC 20510

Dear Senator Domenici:

On behalf of the American Hardware Manufacturers Association (AHMA), we urge you to act to avert a serious problem for the business community. Specifically, we urge you to halt implementation of Internal Revenue Code Section 89. AHMA represents the manufacturing segment of the U.S. hardlines industry.

Section 89 was enacted as part of the Tax Reform Act of 1986 to encourage employers to provide certain benefits, such as medical insurance, to all employees equally regardless of compensation level, if they are offered to any employee. Despite changes made to the law in 1988, and a two-year lead time, even the IRS was unable to come up with adequate comprehensive guidance before the effective date.

We believe this legislation is an example of good intentions gone awry. It is absurd to expect businesses to comply with Section 89 in the absence of regulations. We do not expect, however, that the regulations will greatly reduce the burden imposed by Section 89. We believe only one solution exists; repeal this onerous law.

We look forward to working with you in the 101st Congress.

Sincerely,

William P. Farrell

William P. Farrell
President and CEO

WPF/1347c1

Reply to: Suite 1201 1025 Vermont Avenue, N.W. Washington, D.C. 20005 (202)639-2084

1989 FEB

THE BISHOP'S
LODGE
P.O. BOX 2367
SANTA FE, NEW MEXICO 87504
TELEPHONE (505) 983-6377

February 17, 1989

The Honorable Senator Pete Dominici
New Post Office Building
Room 307
Santa Fe, NM 87501

RE: HR 634

Dear Senator Dominici:

On behalf of The Bishop's Lodge and the 50-125 fine New Mexicans whom we employ, I urge your support of HR 634, which would repeal Section 89 of the Internal Revenue Service Code.

The requirements of Section 89 render the extension of employee benefits, which we so badly want to provide for our employees, impossible.

Section 89 is counterproductive, and will most likely result in the termination of even the rudimentary benefit programs which are currently in place.

Sincerely,

James R. Thorp, Jr.
Owner/Manager

JRT/llr

RECEIVED FEB 2 1 1989

1989 APR -3 PM [illegible] 01

Domenici Seeks Tax Law Change

Congress now has two bills to consider that relate to Section 89 of the Internal Revenue Code.

One would repeal Section 89. The other, introduced Wednesday by Sen. Pete Domenici, would amend the provision.

Section 89, the result of the Tax Reform Act of 1986, seeks to end discrimination in benefits plans. The provision, which took effect Jan. 1, requires an employee benefits plan to pass highly complicated tests. Benefits not in compliance will be considered taxable income. Some employers are threatening to drop benefits altogether rather than meet the expenses of compliance.

"I fear that unless quick action is taken, millions of Americans will lose benefits as a result of an unworkable, convoluted and unfair law," Domenici said.

Domenici's bill would:

- Exempt businesses with fewer than 20 employees from Section 89. This includes about 88 percent of New Mexico businesses.
- Raise the standard for coverage for part-time employees from 17½ hours to 25 hours a week. Presently, Section 89 requires any employee working more than 17½ hours a week or six months a year to be covered.
- Provide that employers offering benefits equally to all employees will be considered to be in compliance with the law even if employees choose to not participate in the benefits package.
- Delay the compliance date for the new law until Jan. 1, 1991, so that financial advisers and business people have a chance to familiarize themselves with the provision.

3/25/89

Senator Domenici — you are to be congratulated for your efforts to amend Section 89 (it is a ridiculous piece of legislation). Keep up the good work!!

CF:
Bingaman
Richardson
Schiff
Skeen

J. G. Muhlberger
One Executive Center Suite A321
8500 Menaul NE
Albuquerque, NM 87112-2298

PS: Let's stop changing the [illegible]

MAR 30 1989

Holsum BAKING CO. DIVISION OF HOLSUM, INC. MAIN AT EIGHTH • P. O. BOX 370
ROSWELL, NEW MEXICO 88201 • PHONE (505) 622-5531

March 29, 1989

Senator Pete Domenici
Federal Building
Roswell, NM 88201

Dear Pete:

In your letter replying to our concerns about Section 89, you asked for suggestions to help small businesses.

Let me present a typical New Mexico scenario. If a number of employees feel that they are immune to illness or plan on applying for indigent relief, they can skew our percentages where we would be subject to discrimination. We do have employees that opt for this and we do offer health coverage to all employees on an equal basis after six months of Full-Time employment.

This section instead of helping us offer coverage, will cause us to seriously consider dropping our health plan and adjusting wages upward. This will not help the employee who will not go and buy coverage.

We think the downside of this plan offsets its good intentions and we're sure that we are not the only small business that thinks this way. Thanks for your attention.

Yours very truly,

Holsum, Inc.
Gene Reischman
Chairman & CEO

cc: Senator Jeff Bingaman
Representative Joe Skeen

THE BEST RENTAL STORE, INC.
1160 El Paseo Road, ste. #D-5
P.O. Box 16185
Las Cruces, New Mexico 88004
(505) 525-9160

APR 11 PM 11:5

Senator Pete Domenici
Room S-D, 434,
Dirksen Senate Office Building
Washington, D.C. 20510

April 6, 1989

Dear Senator Domenici:

This letter is in reference to Section 89. The Best Rental Store has found it in their better judgement and interest not to support section 89.

As a small business, Section 89 is very unbeneficial. With fewer than ten (10) employees, this plan would only prove itself to be extremely costly. Being difficult as it is to supply full time employees with good insurance, particularly health insurance packages, making it mandatory to extend these benefits to lower income employees would not only cause problems for both employer and employee, but be entirely too expensive as well as complicated.

Once again, The Best Rental Store does not support Section 89!

Sincerely,

Tami G. McBee
President/Owner
The Best Rental Store, Inc.

tm:JM

A. R. KENDRICK
BOX 516 • AZTEC, NEW MEXICO 87410 • (505) 334-2555

April 6, 1989

1989 APR 11 AM 11: 22

Senator Pete Dominici
434 Dirksen Building
Washington, D.C. 20510-3101

Re: Bill S-595, Relating to Section 89 of the Tax Code

Dear Senator Domenici:

I favor your "Section 89 Small Business Relief Act of 1989" for the relief it provides to business. However, the relief from taxation for the recipient of an insurance payment was not included.

Employee health should be considered similar to the other amenities offered to all employees. The employees are not taxed for the use of the furniture, the use of the rest rooms, the use of the parking lot, or the ambiance of the work station. Therefore, the employee should not be taxed because he/she elects to remain healthy.

If the United States is to compete with the other industrialized nations of the world, we must not price our labor "out-of-reach" by taxation of the employees.

Take the health insurance payments out of the income category, but leave them to be deducted from medical expenses.

Thank you for asking for comments.

Yours very truly,

AR Kendrick

A. R. Kendrick

E. W. HARRIS
900 HALLETT CIRCLE
FARMINGTON, N.M. 87401

April 6, 1989

1989 APR 11 [illegible] 11: 23

Senator Pete Domenici
434 Dirksen Building
Washington, D.C. 20510

Dear Sir:

I am responding to your recent bulk mailing concerning your SB 595.

In 1956 I bought a small business in Farmington, operated it until January of 1988. In 1979 I established a retirement program which covered all of the seven or eight employees of the business. Almost immediately I saw the paper work could not be handled by me and a service in California was paid to do the work.

The cost in both my time and in money became more than I felt the program justified and I closed the whole thing out in 1984. I suspect the abuses of such plans by corrupt union people back east may have been the reason for the restrictive legislation, but I just couldn't afford to continue the program. It is my understanding that many small employers arrived at the same conclusion.

At the present time the business offers no fringe benefits of any kind to the employees. The laws are too complicated, the penalties and risks of penalties are too high.

Thank you for asking my opinion.

Sincerely,

Ed Harris

E. W. Harris

SPITZER

AUTOMOTIVE AND INDUSTRIAL PRODUCTS COMPANY

511 S. Virginia Avenue
Phone (505) 622-7042

P.O. Box 1695
Roswell, New Mexico 88201

APR -5 AM 7:2

March 31, 1989

the internal

The Honorable Pete V. Domenici
United States Senator
SD-434
Washington, DC 20510

Dear Mr. Domenici:

According to the information I have received, you are not a co-sponsor of S350. I urge you to support the repeal of Section 89 of the IRS code.

This law is a disaster for both employee and employer.

Please help the already over-burdened employers in New Mexico.

Sincerely,

Nick C. McMillen

Nick C. McMillen
General Manager

jm

Senator Pete Domenici
Room S-D, 434, Dirksen Senate Office Building
Washington, D.C. 20510
Local Office 523-8150

Representative Joe Skeen
1007 Longworth, House Office Bldg.
Washington, D.C. 20515
Local Office 523-8245

RECEIVED APR 0 7 1989

Senator Jeff Bingaman
502 Hart Senate Office Building
Washington, D.C. 20510
Local Office 523-8237

The Honorable (Senator or Representative's Name)
U.S. Senate/U.S. House of Representatives
Address Below

I strongly urge you to support legislation to repeal Section 89 of the Internal Revenue Code. Such legislation has been introduced by Representative John LaFalce (D-N.Y.) in H.R. 634. S.350 also repeals this regulation, which if left in place will be harmful to business and employees.

The intent of the supporters of Section 89 was to extend benefits to lower income employees who have not be afforded benefits such as health insurance in the past. The Joint Committee on Taxation stated that these rules should require employers to cover non-highly compensated employees to an extent comparable to that of highly compensated employees. This aim could be construed by some to be in the best interests of American people. However, the real effect of this confusing regulation is going to have the opposite effect.

Employers, particularly small businesses such as mine, cannot afford Section 89. The cost of providing insurance, particularly health insurance, to any employees has become prohibitive to many businesses. To make it mandatory to extend these benefits to employees working as little as 17.5 hours a week could force many of us to drop coverage all together.

Prehaps the most ludicrous attribute of Section 89 is the cost that will be associated with compliance testing. This regulation is so complicated that the IRS had not even been able to issue regulations to explain the law until two weeks ago, even though compliance was to have been required as of January 1. Very few accountants, insurance experts, or other professionals who might be available to help us struggle through the complex testing requirements have enough knowledge at this point in time to be of any service. Once they acquire the ability to be of service, the cost to many businesses will be prohibitive. It will provide another reason for dropping all coverages.

Please consider supporting business as well as the employees. The problem of inadequate health insurance is not going to be solved by Section 89. Many other problems will be created.

3/29/89

LAMSKE INVESTMENTS
☐ P.O. Box 737, Rockport, MA 01966-0837
☒ P.O Box 2096, Las Cruces, NM 88004-2096

STATEMENT OF SENATOR HARKIN
SMALL BUSINESS COMMITTEE
APRIL 13, 1989

Mr. Chairman: The 1986 Tax Reform Act added a new Section 89 to the Internal Revenue Code which applies detailed "nondiscrimination" rules to employer-sponsored welfare benefit plans, including group health and group-term life insurance arrangements.

This section sought to expand benefit coverage for lower-paid workers by taxing benefits of higher-paid workers that exceed limits set by a series of computational tests. The goal of discouraging discrimination in employer-provided health and group-term life insurance arrangements is important.

Unfortunately, the Section 89 rules will in many cases have the opposite effect envisioned by the proposal's original advocates. Instead of expanding coverage to reach more workers, it will result in less coverage -- and we could see many new employers decide against starting any employee insurance plan. And, I have heard of employers who are dropping existing plans because of this section.

The reality is that it can cost many small employers more to expand benefits coverage than to pay the tax penalty required for maintaining a benefit plan that is ruled as "discriminatory." When these employers look at their bottom line, it may make no business sense for them to meet the new requirements. This problem is most significant with small businesses.

Only 46 percent of the employers with fewer than 10 employees offer health insurance plans. That figure jumps to 78 percent for firms employing 10 to 25 employees and 92 percent for firms employing from 26 to 50 workers. Almost all large firms have health plans.

It is the smallest category of firms that is most likely to either eliminate a health plan or decide to not start one.

During the consideration of the 1988 Tax Act, I was able to secure a narrow amendment which allowed smaller employers to not count some part time workers during this and next year. I would have liked to do more. But, that was all that could be accomplished at the time.

Earlier this year, a major effort began to repeal Section 89. Frankly, I do not believe that those efforts are likely to be successful. The concepts underlying, if not the specific requirements of, Section 89 have very strong support in the tax writing committees.

I have worked with Senator Pryor of Arkansas and others to develop the Section 89 Simplification Act, S 654. That measure now has 32 cosponsors. Senator Boren is a leader in that effort. A clear majority of both the House and the Senate have cosponsored measures which would repeal, delay or substantially change this section of the law.

The general thrust of S 654 is to sharply reduce the paperwork burdens and the convoluted testing requirements of Section 89. It is a bill that can actually pass the Congress and become law, not just a statement to wave.

However, I believe that it can be improved.

The bill creates a model plan. If an insurance plan offered by the employer matches the model plan and is made available to at least 90 percent of the employees, the plan does not have to go through the tests required by section 89. I believe this is the best concept for the smooth implementation of a reasonable set of nondiscrimination rules. However, I also believe that the dollar limitations in Section 89 Simplification Act are to low to be effectively used.

The bill would also greatly simplify record keeping and allow more straight forward testing when the prototype plan is not used.

I am very pleased that the Small Business Committee is holding this hearing. I am hopeful that it will provide an opportunity to acquire additional material about the problems that Section 89 creates. And, with that knowledge, I am hopeful that the problem can be eliminated.

Senator BOSCHWITZ. Thank you, Senator.

Now, we will turn to questions of this witness, and then we will move on to the other witnesses.

Senator Boren.

Senator BOREN. Thank you very much, Mr. Chairman.

I say to my friend from Wyoming, I think there are a number of us, and my friend from Michigan, who are going to be increasingly proud of our vote on what flew under the false flag of Tax Reform. Maybe one of these days we will understand that we should stop penalizing saving, investment, and capital formation in this country by changing tax policy to penalize it, as we did in that bill.

But let me ask—I want to focus, and I am relieved to hear you were not here when this dastardly deed was actually done. You seem like too nice a person to have been a part of that. [Laughter.]

Let me ask you——

Senator LEVIN. I think he wants to deny that.

Mr. TRIER. No. It was about the dastardly deeds being done. The point really is, as Senator Levin says is that——

Senator BOREN. Well, let me give you the benefit of the doubt.

Mr. TRIER. I probably would not be smart enough to think up a statute like that.

Senator BOREN. Would you explain to me what exactly is the position, the announced position of the Treasury right now, in terms of delay in enforcing this provision, so that we can understand it.

Mr. TRIER. The exact position is that I am unable to say that it is the Treasury Department's position that we should delay, at this moment, the effective date of Section 89, or the enforcement of the regulations.

Now, that has been something, obviously, that has been discussed over the last week. I would be remiss in my duties if I did not fully explore that question again with my superiors at the Treasury Department. But it is exactly the position that we do not support the delay as of this moment.

Senator BOREN. So that the status quo, and we understand it is under review, is that by January 1, both employers with single plans and multi-plans will have to be prepared to come into compliance at that point; to submit their plans at that point for final approval. Is that right?

Mr. TRIER. With the effective date of this statute, that is right.

Senator BOREN. So, we have given them some more time in terms of waiting to start gathering the data beyond their initial filing. It has to be July 1, as I understand it, under what has been done today.

And now if the Treasury Department were to say today, this, in my opinion, would be a good day to do it. As Senator Symms said, "We are simply not going to enforce this provision for the upcoming, for this tax year, for this taxable year, and therefore, you do not have to have these plans in on January 1."

What penalty would attach to the Department for having done so?

Mr. TRIER. I will give you just a little bit of background on it, but I am, you know, I am really—that is, as you know, historically something that once the law is written, the Treasury Department has difficulty getting to the position that they say they will not enforce a law that is——

Senator **Boren**. Namely, they have just had to say, "Our regulations—we have made a great effort, but we just have not had time to get our regulations together, and we cannot enforce it now."

Mr. **Trier**. Well, that is clear and with the Chairman. I mean, clearly, with regulations, when it is not the law and it is the way we have interrupted the law that raises the problem, we can take care of that real quickly and easily on 1 day's notice.

I think where the greater difficulty comes is saying that we will not enforce the law. The law—forget for the moment the regulations, but a law that is on the books. Just as background again, not meaning to say that this decision is finally made. Of course, one of the places where that difficult decision was discussed the most was in the aftermath of the 1986 act, when technical corrections were ongoing, and I am aware that it is something that is very troubling to people.

Senator **Boren**. Really, the only penalty, if there is a penalty, there is not a criminal penalty attached to you, or to the Secretary, if you were to make such a statement.

The only penalty that would be assessed would be the potential, the political penalty imposed by Congress in terms of being more difficult to get along with.

Now, if the Chairman of the two responsible Committees, the Ranking Members of the two responsible Committees, which are principally Ways and Means, and Finance, were to join in an appeal to the Secretary to say, "We want you to make such a statement on this delay; we anticipate taking up legislation to either delay the effective date for another year while we work on it, or we want to make some major changes before it is imposed. There would really then be no practical impediment.

Mr. **Trier**. Yes. I think, Senator, that that kind of joint action is extremely helpful. The problem that you might understand, when you are thinking about it is, of course, that we have to be able to divide the line between those things in which we just do not enforce, because we do not agree with it, and those things that everybody in the world would agree that perhaps we should not enforce it.

And it is a tricky question. It is a difficult question, but I understand your sentiments fully.

Senator **Boren**. I, again, would just join with the others in urging you to carry that message back to the Secretary. We will be speaking to the Chairman and Ranking Member of our Finance Committee, and will endeavor to send that message across the other side of the Capitol, as well, to see if we cannot get some sort of a joint statement together and get some kind of an agreement.

Because every day that we delay, there are honest, law abiding small business people out there and businesses of all sizes. And, certainly, 99.9 percent of these people are honest, law abiding people, and it is unfortunate they are being penalized because of the perception that there could be a handful of people not acting in this manner out in the country.

And the other thing is that many are going to start canceling plans. And not just small institutions. They are financial institutions in my State, and others, of some size, that I hear from, and say, "Look, we are so worried about this, the idea that the penalty's imposed in a way if you are just 1 percent off, or a fraction off, you fall over the cliff, and your whole plan is disallowed." Then, all your employees are penalized.

It is my fear that we are going to have a substantial number of plans cancelled before we take action to let people know. So, I would urge that for once, I think, we should not pass the buck around, and delay a decision and postpone a decision, that we ought to try to get a decision before this week is out from a joint action from the Secretary and the Congressional leadership in this matter, so that we can forestall that kind of tragedy.

Now, let me ask, in devising these regulations, undoubtedly, you have come up with a lot of opinions as to where the faults are in Section 89, as now written, in terms of the legislative remedy.

What are some of the areas? Have you looked? Let me ask you, have you looked at S. 654 in terms of some of the proposals like exempting plans——

Mr. **Trier**. Remind me of the sponsor.

Senator **Boren**. That is Senator Pryor's legislation, and the other three I mentioned are basically delay, or small business repeal delay, or small business exemptions. So, they are pretty straightforward.

The Pryor bill is the one that, I suppose, goes into more actual changes in particular portions of it.

Mr. **Trier**. From what I understand, Mr. Rostenkowski's bill has some similar things.

Senator **Boren**. It has similar provisions. It would expand the rule for testing part-time employees from 17½ hours to 30 hours. It would exempt, I believe, non-profit foundations, and maybe local units of Government. It would also exempt those that have 90 percent of employees covered, and the mandatory employee contributions do not exceed $6.70 per week for employee-only coverage. And $13.40 for dependent coverage.

In your opinion, how helpful would these kinds of changes be, and are these among the most important, or are there some other areas that you would identify from your experience of writing the regulations or——

Mr. **Trier**. I think what you have said, particularly starting with the last one that you have mentioned. You have, to my mind, covered, just by that description, those things that I think are on the table.

Let me sort of state a conception. I think the—as I said in my remarks, in the summary of my remarks, I think the key problem is having to do the testing. That is the most significant, single problem.

The approach that the pryor legislation takes is one approach to that, which is to say, if you cover people, and if the required contribution by them, to get something under the plan does not exceed certain amounts, that we can be reasonably confident that the overall purposes have been satisfied.

I think, whether or not the numbers are correct, or whether or not a——

Senator **Boren**. Yes, $6, or $8, instead of $6.70, or whatever.

Mr. TRIER. That concept is clearly one of the major concepts that we are all focusing on.

A second one, that you also alluded to, is exactly where you draw the line with respect to the part-time employees. Most people are dissatisfied with 17½ hours, the current situation.

My own view of that is that 17½ hours may, in fact, be the wrong place to draw the line. I do think some major questions arise once you start getting up around 30 hours, or whatever, it really comes to what your view of the obligations of an employer toward somebody working that much are. It is a little beyond the taxpayer.

But, again, I think that is a very major question. I think the tax exempts is another thing.

I think the two we have mentioned, though, for the core group of employers is very major.

I think a third, which is apropos here, and we do not have a defined position on, is whether, in fact, there ought to be some special rule for small businesses. I think the concept there would be; a, the cost of compliance are greater, and b, there is natural impetus, if you are going to cover people, to cover more than a few people, because you benefit from group coverage. So that, perhaps some of the full-blown apparatus of Section 89 is not quite as necessary.

Senator BOREN. If you started with the small business exemption, taking smaller businesses out, and then——

Mr. TRIER. I have not agreed to that.

Senator BOREN. That is one of the things that would be something that should be seriously considered.

Mr. TRIER. Well, I think some special treatment of their situation should be considered.

Senator BOREN. And then, additional changes and definitions of part-time employees, and perhaps allowing certain large numbers of employers of any size ought to be completely taken out of the onerous testing requirements if they——

Mr. TRIER. So-called design-based.

Senator BOREN. For certain designs.

Mr. TRIER. Right. And I think that is the kind of—those are the core issues we have been talking about.

And the only one I do not think you mentioned is that—I am not sure we have well-formulated views on, but is often brought to our attention, is the required application of the rules when you have collectively bargained plans that are covered.

So, with that group I think you have covered a lot of the core issues that——

Senator BOREN. That, obviously, is another area, because it has from time to time been a principal focal point of collective bargaining, and you would assume that if you have gone through the collective bargaining process about it, that there certainly has been a great deal of microscopic attention being paid to the fairness of and treatment of all employees, and so on, particularly those lower-level employees.

Mr. TRIER. Right. I mean, I think a lot of employers would argue that, also, they do not have much control over that.

Senator BOREN. But, therefore, you should not go back and revisit that, if there is a collective bargain agreement on that subject.

Mr. Trier. But, you know, I think it is clear what my superiors, at the moment, think. We are thinking about all of this. And we know you are thinking about it, and other people are thinking about it. And this is part of the process that, whether or not a delay of the effective date is accomplished, I would hope we all work faster on attacking the basic core problem.

Senator Boschwitz. Thank you, Senator Boren.

Senator Lott, I think was, you are next.

Senator Lott. Well, we appreciate your being here, and I know you are in a difficult position.

Mr. Trier. They call this the hot seat.

Senator Lott. And it is interesting that they sent you into the pits, since you were not even here when it all began. You know, I do think that we should acknowledge that you have a burden in the Treasury Department to enforce the laws that we wrote.

And you have an obligation to try to devise regulations to implement that law, so I do not think it is really very fair for us to be dumping on the Treasury for doing what is required of you.

But I do think, obviously, there are major problems with those regulations. And I think it is evidenced by the fact that it took so long to develop interim regulations.

And I mean, I ask you that question, why did it take so long? Was it because of the complexity and the difficulty of trying to develop——

Mr. Trier. I think it is essentially three things. I think it is the complexity. I think it is the fact that there—whether or not it is accepted that there was some flux in what the law was actually going to say as, during the technical questions legislation. There were modifications that were continuously being discussed, and finally made.

And I think the third point which is not one that people like to look at sympathetically, but I can say with all honesty, that the people working for me, who work on employee benefits regulations, have had one heck of a load since 1986. And every day that I come in on Saturday and Sunday, the first few names that I see signed in, are the people who are working on those regulations.

And they are not simple, and we could have done it faster. There are others we still have to do on the other employee benefit provisions. And we all feel bad about that, but I, myself, personally, have a little trouble telling these people that they are poor public servants.

Senator Lott. Well, you know, we have an immediate problem. Now, the law went into effect January 1, 1989.

Mr. Trier. Right.

Senator Lott. Interim regulations were out March 2, 1989, correct? When do we expect complete regulations to be out, barring some change in the law?

Mr. Trier. I have been wrong so many times, that I hate to say. But, I think, later this year, or by early fall, would be the best we can assume that we would have anything.

Senator Lott. Early fall for complete regulations on a law that has already gone into effect January 1. I mean, think of the condition and the position of the small businessman.

And I think we should emphasize a couple points we have just touched on today. It also includes schools, is that correct?

Mr. TRIER. I understand.

Senator LOTT. As well as these small entities of Government—the large and small.

And as you were talking about exempting this group, exempting that, some sort of small business exemption taken out, Government entities, taking out schools. And at some point, the question would be, "Who is left?"

You got—the major corporations have these things——

Mr. TRIER. Right. I might say that I think you said earlier that I, myself, in terms of actually excluding people have a little trepidation, because that is a process that once you start, not only is it hard to stop, but you wonder why you are treating one group one way, and another group another way.

So, I think, those raise difficult issues, but——

Senator LOTT. I am sure that the intent was—well, you know, it was well-intentioned. It was noble. But, I think if it is so noble, we should not start letting people out of the basket, quite frankly. And while I will always generally support the concept of exempting small business, I think in this case, the whole concept is just not workable.

But we do have an immediate problem, and I want to commend what Senator Boren was suggesting there. I think it is really essential that we get together with the Treasury Department, Secretary of the Treasury, and the two Chairmen. We have had a very strong statement from Senator Bentsen, and it looks like Chairman Rostenkowski is moving into this area, and get some immediate action to be taken, so that small businessmen and businesswomen across this country, and governments understand that they are not in violation of the law, if they do not comply with incomplete regulations, which they probably could not comply with anyway.

So I hope that you will take that on yourself, to take that message back to Treasury. I think it is incumbent upon us, as Members of the Senate and this Committee, to work with our leadership, to see that that is accomplished.

Then, when that is done, you know, I thought I heard you get very close to saying that maybe there was a feeling that this whole thing should be repealed, but you did not say it.

Mr. TRIER. That is right. [Laughter.]

Senator LOTT. Well, let me ask you this way. I thought I heard you say the position was that it should be delayed, but then I thought you indicated that that was not the position.

Mr. TRIER. I certainly do not have that license to say, either that it should be delayed, or that it should be repealed. Now, that does not mean I am not going to take the message back, and we are going to continue to discuss it.

Senator LOTT. Well, let me ask it this way. As a friend of the administration at this point. [Laughter.]

What is the administration position on Section 89? Now, let me give you a suggested answer, before you respond. [Laughter.]

The suggested answer is that this matter is percolating to the top. It is of great concern. We are now focusing on it, and the administration will soon have a very strong position, but what is it?

Mr. **Trier**. I think it is much stronger than that. I mean, I went out of my way to try to get us to agree to that strongly. It is certainly well beyond having percolated to the top. I think it is the focus of attention, and I think it is, also, which I say in the conclusion, it is absolutely clear to us that a lot of the problems, whether or not you cast dispersions on people personally, which is not the way I look at it. But that a lot of the problems in implementation were just not understood.

It is obvious to all of us, and it is our formal view that parts of the statute, or the way it acts in operation, were just plain ill-considered. It is quite clear to us that the legislation should, in fact, be subject to major surgery, at the least——

Senator **Lott**. So, at this point, you are not ready to say repeal, or delay, you are saying major surgery——

Mr. **Trier**. Roll up our sleeves and go to work and——

Senator **Lott**. All right. You are aware, I am sure, that major surgery in the Congress, which goes through both bodies and is signed by the President, normally takes weeks or months. And we are talking about a tax bill, and there are literally hundreds of us in the Congress, waiting back in the bushes for the first revenue bill to come through.

Mr. **Trier**. I am very aware of that phenomenon.

Senator **Lott**. And once we get a crack at it, it is not going to be just major surgery on Section 89, it is going to be a bunch of other things, probably, and fortunately, and unfortunately.

So, again, that brings me back to the earlier point. That will take us probably, you know, June, July, for heavens sake, maybe this fall, and the thing languishes. And that is one, of many reasons, why, I think, we need to look—we made a mistake.

It is like the logging of mileage on automobiles. It is like the withholding of interest and dividends. This is a boo-boo. Let us make a nice, clean break. It does not work. It is conceptually wrong.

If we start excluding—I mean, you say, yourself, you are not sure yet where we would make these modifications exactly, so who—in 17½ hours—who came up with that number?

It is incredibly complex, difficult. It presumes bad faith on the part of small businessmen and businesswomen in this country. I think that is wrong.

I have a statistic here that over 80, maybe 85 percent of the American people now are covered by these plans. Is that your understanding?

Mr. **Trier**. Yes.

Senator **Lott**. Why are we doing this?

So, take it back to the administration from a present friend, and make a clean break. Let us get out of this thing. Let us repeal it. Thank you.

Senator **Boschwitz**. Senator **Levin**.

Senator **Levin**. Thank you, Mr. Chairman.

Let me try to suggest an answer to—you said that this has done more than percolate to the top. Is it fair to say that it has boiled over for starters?

Mr. **Trier**. I am not sure that I know what boiled over means?

Senator **Levin**. Is the Secretary of the Treasury personally involved in this issue?

Mr. **Trier**. I think that the Secretary of the Treasury is clearly personally involved, as is the White House.

Senator **Levin**. All right. Are you speaking for the Secretary of the Treasury this morning?

Mr. **Trier**. I am speaking, certainly, in the overall conclusion of the—on Section 89, I am speaking, not just for the Secretary of the Treasury, but for the administration, my conclusion on the ill-considered and whatever the language that was hammered out.

Senator **Levin**. So the administration believes that the statute was unwise and ill-considered.

Mr. **Trier**. Parts of the statute.

Senator **Levin**. We are talking about this section.

Mr. **Trier**. What the provision says, "that parts of the statute section 89 were ill-considered."

We understand where the policy impetus came from——

Senator **Levin**. Forget that. We have an ill-considered Section 89, right? That is the administration's view?

Mr. **Trier**. Ill-considered parts of the statute.

Senator **Levin**. Significant parts of Section 89 are ill-considered?

Mr. **Trier**. I am willing to say that.

Senator **Levin**. We have got regulations which you indicate you are dissatisfied with yourself.

Mr. **Trier**. I did not say that. I said that I do not think that the regulations could have, and I do not think they do, answer the fundamental problems that are raised by compliance with them.

Senator **Levin**. It is safe to say we have inadequate regulations?

Mr. **Trier**. It is safe to say that they are inadequate to deal with the fundamental problems, as with any regulations.

Senator **Levin**. So, we have got a statute, which in its significant portions is ill-considered. We have got regulations implementing it which are inadequate to handle the problem.

We have got folks out there that are trying to scramble to figure out how to meet the requirements of this ill-considered statute, whose regulations do not solve the problem. They are hiring accountants, lawyers, trying to figure out what to do to meet it.

In the case of schools, by the way, putting together budgets, trying to figure out whether or not they are going to have to comply with this or not.

We have got employers dropping out of health plans.

Now, we have got a real time crunch on our problem, and my question to you is very narrow in its focus. Why not waive penalties, which you have got the power to do, for failure to comply with this ill-considered, unwise, inadequate statute and regulations?

Why not simply say you are going to waive the penalties, until we can figure out what to do? At a minimum, why not?

Mr. **Trier**. Let me first say that I will raise that question, as I have raised the other questions, fully, with everybody within the administration.

I think that as, and in general, the concept of doing something quickly, I think the question that is raised by doing that, is the same question as exists with respect to any waiver of application of the rules.

Senator Levin. We have done that before, though, have we not? Treasury has waived penalties before, administratively?

Mr. Trier. Yes.

Senator Levin. So, you have the power to do that?

Mr. Trier. Most certainly, we are given the statutory power, in some cases, and I think you are correct that there have been waivers of penalties before.

Senator Levin. All right. I would urge that this week you let, or early next week, you let the world know that is trying to live with this burden, which is really an unjust burden. It has exactly the opposite effect of what we intended.

We did not intend for there to be a reduction in the number of health plans, and that is the effect that it is having.

So, you have got a statute that is having exactly the opposite effect of what is intended. You got people laying out lots of money, struggling to meet the bureaucracy and the redtape that has been imposed upon them.

I would hope that within a matter of days—this is a fairly simple question, that the Treasury decide whether to waive penalties for non-compliance with Section 89. That, I think, we ought to be able to get within days.

While we are figuring out whether radical surgery is the answer, or whether or not repeal is the answer, at a minimum, I would hope the Treasury will give us an answer by the middle of next week, let us say?

Mr. Trier. As to whether we are willing to do that? I will raise that immediately with the Secretary's office.

Senator Levin. And one other thing. It is very true, as Senator Lott has said, that you do have the burden to enforce the law. There is a law on the books. You have the burden to enforce it. But you also have the power, not only to waive penalties, you also have the power to make recommendations for changes in that law, to recommend that it be delayed in its implementation.

So, it is not going to be enough for the Treasury just simply to say that, "Look you passed a bad law," which we did. You are going to have to bite that bullet as to whether or not you want to delay its implementation, and whether or nor you want to recommend changes. And I urge you to do it quickly.

This is a growing problem out there, and the timetable, I hope, would be a short one. Not just on the question of waiver of penalties, but also on the question of amending the law, or repealing the law, which is, I think, the more likely thing, under these circumstances.

Do we have your one commitment, by the middle of next week, to give us an answer on the waiver of penalties?

Mr. Trier. I will give you my commitment to attempt to do that.

Senator Levin. Thank you.

Senator Boschwitz. Thank you, Senator.

Senator Wallop.

Senator Wallop. Mr. Chairman, thank you.

I am always a little bit amused when we in the Congress, who pass these things, find somebody else to flail. [Laughter.]

Mr. Trier. That is part of my role, I am sure.

Senator Wallop. And either we have the power to appeal it——

Senator LEVIN. If I could ask you to yield for a minute, I could not agree with you more.

It is going to take us some time, as Senator Lott has pointed out to repeal or modify this. It could take them 2 days to waive the penalties on it. I am not flailing them for a lousy law. I voted against that law. So, I am perfectly happy to flail us for a lot of that. [Laughter.]

Senator WALLOP. But, I would say, that when we finally got around to it, it did not take us more than about 48 hours to repeal the automobile logs either.

And it took even less time than that for us to get the Redskins on television on Sunday. [Laughter.]

I mean, there is plenty to go around, so please understand that I sympathize with your posture. I also sympathize with the suggestions that have been made to you, because it is clear, and we opted not to even try to do this yesterday. So that if we are going to be rescued, it is, obviously, going to be the Treasury Department that rescues us from ourselves.

My problem is this, that even the authority which you possess to waive the penalty, does not quite help. It helps some, but it does not answer all the problems.

I have a letter from a school district in Wyoming, and they are not different from a number of small businesses, but every day that that goes by, you know that sooner or later a penalty will be reinstituted, for what, and at what time, you do not know.

The school district says that they have had numerous insurance, accounting, and private consultant firms, and computer software sales companies, contacting our office, wanting to do compliance testing for the district, at costs ranging upward for $9,000.

These are costs that are impossible for some small businesses, especially in a State like mine, and the Senator from Oklahoma's, where our economy is not singing quite the same cheerful tune that some other parts of America are doing.

So there is a huge financial burden on them. And I know for a certainty that tax counselors from Wyoming, accountants, and others, are suggesting that we just abandon all kinds of plans, rather than to try to comply with mysterious, anti-discrimination rules, when in their minds and their efforts they do not.

Let me just ask one question, and that is that, if an employer's pension plan meets the non-discrimination requirements under ERISA, would it not seem to be a reasonably valid assumption that their health insurance plans would also be non-discriminatory?

Mr. TRIER. I think it is quite often going to be true that they do. But, I do not think you can say within any certainty.

Senator WALLOP. Well, you cannot. But the biggest problem here is that this is an accusation to all of these entities that are covered by the rules of Section 89 that they are operating in bad faith.

So, instead of going after people who are clearly operating in bad faith, you are accusing everybody to prove that they are not.

You—please understand me.

Mr. TRIER. You, in the objective sense.

Senator WALLOP. I mean, you, as a collective you. One of the very many reasons that I voted against it.

But, it is clear that the conversation here, and the behavior of the Senate yesterday, that we are going to have to rely on Treasury to save us from ourselves, unless the political heat gets a little greater.

I just urge you to do as much as you can, while this crumbling body gets around to doing what it really ought to do, and has the power to do, is something to correct what it, in fact, required you to do.

Please help us help ourselves. Thank you.

Mr. TRIER. Thank you.

Senator BOSCHWITZ. The Chairman of the Committee is with us. Do you want to make any comments?

HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

The CHAIRMAN. I just heard that there have been 18 speeches made before I got here, so I will defer, and yield back the balance of such time as I would have otherwise used.

Senator BOSCHWITZ. I think that every Member of the Committee has been here today, which is certainly an unusual occurrence.

The CHAIRMAN. All you have to do is look at their mail to understand why. [Laughter.]

Senator BOSCHWITZ. I thank you, Mr. Trier. Several of the Members of the Committee asked, frankly, why we get the tax legislative counsel of the Office of Tax Policy as the witness, why not some Assistant Secretary, the Secretary, or Deputy Secretary.

And the reason is that even in the Department, apparently, there is not a great deal of familiarity with Section 89 and the regulations.

Mr. TRIER. There is also no Assistant Secretary for Tax Policy at this point, nor a Deputy Secretary.

Senator BOSCHWITZ. In addition, there are carryover people. And so that there—within the Department, not a large number of people who can undertake to testify on this. But, we appreciate your testifying and your spirited defense. It is very frustrating.

Let me see if I can just pin down a little bit one final question, and then we have to get to the other witnesses.

The IRS regulations provided a transition rule, starting in 1989 that, "Reasonable and good faith compliance efforts will satisfy Section 89's qualification requirements."

Can you give any definition to reasonable and good faith?

Mr. TRIER. I think it is looking at the statute, looking at the legislative history, and consistent with the spirit of that, doing the best you can.

Senator BOSCHWITZ. Well, thank you very much, Mr. Trier. We appreciate your coming.

And now we call on panel three, which is Ms. Ann Houle of the League of Cities of Minnesota; Ms. Terri Neese, the director of small business of the Oklahoma Chamber of Commerce and Industry; and Reed Stigen of Charles Bailly and Co. of Moorehead, MN.

We will also ask Ms. Valerie Hansen, the chief executive of Big Buck building centers of Racine.

If you would pull a chair up to the end of the table. Just move some of the stuff away.

And James Legos of Legos and Legos of Springfield, OH.

Ann Houle, please.

STATEMENT OF ANN HOULE, RESEARCH ANALYST AND ATTORNEY, LEAGUE OF MINNESOTA CITIES

Ms. **Houle**. Thank you, Mr. Chairman.

I represent the League of Minnesota Cities, which is a member organization of almost all the cities in Minnesota.

This issue is important to small businesses in more ways than just their own business. The small business people may have to pay higher taxes for local governments to comply with Section 89.

And further, small business people are the majority of our council members, town board supervisors, school board members, and county commissioners in Minnesota, and in most States in the country.

There are a total of 854 cities in Minnesota, and we have heard from a lot of them on this question. The most important impact of Section 89 is that most of our cities do not understand, or have the staff to determine how to comply, without the assistance of employee benefit consultants, or lawyers, or tax accountants.

In Minnesota, 753 of our cities have populations of less than 5,000 people, and these communities represent nearly 90 percent of the cities in the State.

The smaller cities are nearly two-thirds of the total number of cities. Of the four million people in our State, nearly two million reside in these very small communities.

In the smaller cities, those under 2,500 population, normally there are many more part-time employees, than full-time staff.

In the 217 cities with populations of less than 250, there are often only two or three full-time staff members.

In most Minnesota cities, only one city employee, and that is normally the city clerk, or city manager, is the official who must conduct testing of employee benefit plans to determine whether the city is in compliance with Section 89.

These people are sometimes people who cannot figure out how to do their W2 forms, or fill out their 941 quarterly reports. There is no way that they are going to be able to do the Section 89 testing without assistance.

Most of our cities in the country and in Minnesota, of course, are not the large, urban cities with large staffs. They are the main street communities with small staffs, full-time staffs, and an awful lot of part-time employees.

The employee benefit consultants and lawyers, and tax accountants have been out offering, generously, to help us comply, for a fee. We have calculated estimates of the cost to contract with consultants, assuming that nearly all cities in Minnesota will have to hire consultants, because they simply do not have the expertise to comply with Section 89.

For cities, we estimate that the cost would be about $3,500,000. There are other units of Government which, of course, are subject to Section 89. We have 87 counties. We estimate it would cost at least $500,000 for them to do the testing, using consultants.

We also have 1,800 townships in Minnesota, and with the consulting contracts that we have heard have been offered to them to comply with Section 89, the cost would be about the same as that for cities—at least $3.5 million.

And, of course, all these costs figures are only for the first year of testing. This is an ongoing testing process, the way the law stands now.

We have 434 school districts in Minnesota, and our estimated costs for their compliance would be $3 million.

So, the preliminary estimates of cost for all of the local governments in Minnesota would be $11 million for the first year of testing. Multiply that by all the rest of the states, and you see what a problem you have, only for local governments, not even including small businesses.

Another problem is that Minnesota governments, and most governments in other States have strict levy limits, and they cannot increase property taxes to comply with Section 89. Any required costs for complying with Section 89 may come out to be a reduction in basic services and staff.

If they are able to raise taxes, they have some leeway before they reach their levy limits, obviously the taxpayers are going to pay for this compliance, and small businesses pay a large part of the taxes that are imposed by local governments.

As has been mentioned several times already this morning, some small cities may decide that the hassles involved in providing health and life insurance benefits are just not worth it, or they cannot afford consultants, and they will stop providing such benefits. This is already happening in Minnesota with some of our smaller units of government.

We have urged Congress to establish a safe harbor for the local government units. For example, to consider that employee benefits, health and life insurance are not discriminatory, if everyone gets the same dollar amount of coverage. That would be one way to take care of it.

One of the problems is that we have been unable to find out from Treasury who an officer is in local governments. We have to assume that it would be the city clerk or the city manager, or the chief administrator of the city.

If the salary test, which now is about $52,400, for highly compensated employees, if that were the only test, this would not affect all of our cities. However, under the present rules, if an employer has no highly compensated employees under that salary test, the highest paid employee must be designated as the highly compensated employee under the plan.

In a lot of cases, that individual is going to be a part-time city clerk, or city administrator, earning less than $20,000 a year. As a matter of fact, I personally know of six city clerks who make under $15,000 a year. They all qualify for, and indeed, received earned income credit. And these are the highly compensated employees.

Now, that is an absurd result, but that is the result under the law and the regulations as they are now written.

Senator **Boschwitz**. Ms. Houle, I do not want to interrupt you, but we took a little longer because of the large turnout of Senators, which probably will have some of the desired effect that you and some of the other witnesses want. And I know that you have come a long way, but I would ask you to be as brief as possible.

Ms. **Houle**. Actually, I am just at the end.

I think the most sensible solution that we would urge is to exempt local governments, if, in fact, the law is not repealed entirely.

If that is not possible, we support S. 654, which would repeal the rule requiring the designation of the highest paid employee as the highly compensated employee, where the city has no one who makes the $52,400 a year.

And if that would happen, then the city would not have to perform the testing procedures. And we urge that, at the very minimum, that this approach be taken.

Thank you for asking us to testify, Mr. Chairman.

Senator **Boschwitz**. Thank you very much. The entirety of your statement will be included in the record.

I note that in my copy of it it goes from page 7 to 9, and so you might be sure that we have——

Ms. **Houle**. We will check that.

[The prepared statement of Ms. Houle follows:]

League of Minnesota Cities

183 University Ave. East
St. Paul, MN 55101-2526
(612) 227-5600 (FAX: 221-0986)

STATEMENT OF LEAGUE OF MINNESOTA CITIES ON ADVERSE IMPACT OF I.R.S. SECTION 89 NON-DISCRIMINATION REGULATION OF EMPLOYEE HEALTH AND LIFE BENEFIT PLANS

TO

THE SENATE SMALL BUSINESS COMMITTEE

Thursday, April 13, 1989

Presented by Ann Houle, Research Analyst & Attorney

League of Minnesota Cities

I. ADVERSE IMPACT AND COST OF COMPLIANCE WITH SECTION 89 REQUIREMENTS FOR CITIES IN MINNESOTA

The League of Minnesota Cities is a statewide cooperative association of cities, ranging in size from 370,000 people in our largest city, Minneapolis, along with just two other cities of the first class - those with populations in excess of 90,000 people: St. Paul and Duluth - to the more than 200 cities in the state with populations of less than 2,500. Just two other cities, Rochester and Bloomington, have populations of more than 50,000. That may be of interest since it is my understanding that testimony heard by the House Small Business Committee from the U.S. Conference of Mayors is possibly the only other official source on the record of the impact of these far-reaching regulations on local government. Most of the member cities of the U.S. Conference of Mayors have populations of more than 50,000. That is an entirely different set of facts from those in Minnesota.

There are a total of 854 cities in Minnesota; the League represents 790. It is important to take note of this fact because the existence of large numbers of cities with very small populations plays an important part in explaining the impact on cities of the costs of compliance with Section 89 non-discrimination testing requirements. The most important and alarming impact of the Section 89 regulations is that most cities in Minnesota do not understand or have the staff to determine how to comply without the assistance of employee benefit consultants or independent accounting firms.

Let me explain. In Minnesota, 753 of our cities have populations of less than 5,000; those communities represent nearly 90 percent of the of the cities in the state. Nearly 75 percent of those cities actually have populations of less than 2,500. On a statewide basis, the smallest cities represent nearly 2/3 of the total number of cities. Of the 4+ million people in the state, nearly 2 million reside in these very small communities.

In the smaller cities, those under 2,500 population, there are usually many more part-time employees than full-time staff. In fact, in the 217 cities with populations of less than 250, there are often only two-three full-time staff. Even in somewhat larger cities, those those between 1,500 - 2,500, there are often less than 10 full-time staff.

In most Minnesota cities, that personnel system translates to the fact that only one city employee, usually the city clerk, is the the official who must conduct the testing of employee benefit plans to determine whether the city is in compliance with Section 89 non-discrimination requirements. The problem is obvious to staff at the LMC Office: these employees often serve part-time and have little or no direct experience with the design or administration of employee benefit plans. Therefore, the first step many of these cities are going to take (if they have not already done so) is to pick up the phone and ask for help.

That situation cannot be much different from the circumstances that are likely to exist in most other units of local government throughout the United States. Most cities are not large urban central cities; they are the "main street" communities with a small permanent, full-time staff supplementeed by a larger, temporary and seasonal complement of workers hired on an as-needed basis.

To get back to my initial discussion of cities' requests for technical assistance -- at the other end of that connection are employee benefit and accounting consultants who offer to aid the city to comply with the federal non-discrimination regulations for public employee health and life benefit plans. Of course, many of these firms had already approached cities last fall or earlier to contract for such services - even before the U.S. Treasury had published the first set of Section 89 regulations and compliance instructions for local government.

The "big eight" accounting firms on a national level: Arthur Anderson; Arthur Young; Deloite, Haskins & Sells; Peat Marwick; and others are well-known in Minnesota as well. They and a host of smaller firms have all been fully engaged - and gainfully employed - for months now - gathering data and giving seminars to everyone they can interest in hearing the "latest, most incisive analysis" of Section 89 requirements.

On the basis of only preliminary information from Minnesota cities and informal contact with other units of government likely to be affected, we have calculated the following estimates of the cost of those initial agreements to contract with consultants to determine whether city employee benefit plans meet federal non-discrimination requirements. In trying to do this, League staff has assumed that nearly all cities in Minnesota will resort to hiring outside experts to assist them in determining whether their employee health and life benefit plans meet Section 89 requirements. The League believes it is reasonable to assume that to be the case from the results of conversations and contacts with both large and small cities on this topic over the last several months.

The League has generally urged cities not to simply agree to contract immediately with a particular firm and has advised cities to evaluate the credentials, performance, and overall cost of services of several employee benefit or accounting consultants prior to signing any contract. It is evident, however, that the difficulties posed by the required analysis of numerous employee benefit plans will make it necessary for all but the largest cities in Minnesota to hire outside help to comply with Section 89 non-discrimination regulations.

So, part of the answer to your first question regarding the adverse impact of Section 89 is the high cost of compliance. The League's preliminary estimates suggest that costs could run as high as $3.5 million for cities in the state. That is just for the analysis of currently offered employee benefits covered under Section 89.

There are also other units of municipal government in the state which have to comply as well. Without going into more detail, it can be estimated that it will cost counties in Minnesota at least $500,000 to do the testing; and that estimate is based on a cost of only $6,000 per consulting contract for all 87 counties. While some of the larger counties would handle the compliance measures in-house, it is clear that many of the counties with populations of less than 20,000, which represent a third of the county units in Minnesota, will be likely to need technical assistance in conducting testing of the various employee benefit plans.

Bear with me. We have not even begun to scratch the surface of the question the committee has asked the League to address. But the realization should have begun to emerge even at this point that we are not simply talking about a non-discrimination standard that is easy to apply and implement. Rather, it is a formidable, confusing, elaborate set of hoops through which the Internal Revenue Service expects all units of government to jump in order to prova that the benefit plans provided to public employees do not discriminate in favor of highly compensated employees.

There are also 1,800 township government units in the state. Even though their employee complement is almost entirely part-time, it will be necessary for their staff to determine whether they will need outside assistance to test employee benefit plans available to some or all of those part-time personnel. Even if the costs of such consulting contracts is considerably reduced ($2,000 per contract), the cost would match that for cities: at least $3.5 million, just for the first year's testing of existing plans.

In addition, there are school districts, with many employees and a more complicated personnel and organizational structure. Undoubtedly, school districts, too, will need assistance to comply. In that instance, without direct information about the particulars of the situation for school district public employment, it is only possible to offer the "guestimate" that most of our 434 school districts in the state will employ either consultants or current staff to do the testing. Our estimated cost for that initial task for schools is our best guess at this point: $3 million.

In total, then, the preliminary estimates of costs of compliance for units of local government in Minnesota could total at least $11 million for the first year. For cities, as a part of that total, the cost could be $3.5 million in 1989. Please keep in mind one other additional important factor for cities. In Minnesota, the legislature has established strict levy limits on the authority of cities to increase property taxes. Many cities are already at the limit of property tax levies allowed by law for their jurisdictions jurisdictions. Any increeased employee benefit costs could produce a circumstance in which the city would face the unpleasant prospsect of reducing basic services and staff.

Let me now go through some of the compliance procedures that cause the most problems for cities:

- Under the current regulations, the city is permitted to exclude employees with less than 6 months of service; those who work less than 6 months per year; and employees under age 21, but employees in these categories may only be excluded if none of them is eligible for benefits;

- In determining who are the city's highly compensated employees (HCEs), Section 89 does not make it clear whether a city clerk or councilmember would be "officers" for purposes of the definition. Even if the city has no employees who are paid more than $75,000; or are paid more than $50,000 and are in the top 20 percent of all employees in compensation; or is an "officer" and is paid more than $45,000, the city may still be said to be required to have at least one HCE, according to some views of the intent of Congress on this point.

- Whether or not the city clerk, treasurer, councilmembers, or mayor are "officers" for purposes of Section 89 is a very important issue, especially for smaller cities. This, in effect, will determine whether or not small cities will have to go through the extensive testing procedures to prove that their employee benefit plans do not discriminate in favor of HCEs, even though they do not have any HCEs.

- There are two options for testing employee benefit plans. One is the "80 percent coverage" test; a plan passes the test if at least 80 percent of the non-HCEs are enrolled under the plan. But if the city has more than one "plan," it appears impossible for both plans to pass the 80 percent coverage test.

- In the testing, "benefit" is defined as the net value provided by the employer. One problem is that there has not been a method provided to figure out a plan's value. The I.R.S. is expected to develop a table to give that figure, but up to now, cities have had to assume that "value" means total premium cost of the plan.

- If a city has plans that are considered discriminatory under Section 89, the city has two options: one - to amend the benefit package to eliminate the problem through either increasing benefits and/or eligibility for non-HCEs or decreasing benefits for HCEs - or to concede that the plan discriminates and include the discriminatory excess that HCEs receive in their gross income which the city reports on the W-2 form, making it taxable. That may turn out to be cheaper than increasing employee benefits across the board.

* Another unintended result might turn out to be that some smaller cities may decide that the hassles involved in providing health and life benefits just are not worth it and decide to stop providing such benefits, opting instead for giving employees a one-time raise equal to the premiums the city used to pay.

II. VIEWS ON LEGISLATION TO MODIFY OR REPEAL SECTION 89

City officials understand that in order for employee health, life and other fringe benefits to be exempt from taxation as income, the plan must be qualified, under penalty of tax liability and fines. In that situation, it is the League's view that cities will have little difficulty with establishing that their employee benefit plans are qualified under Section 89. The five requirements specified in the tax code provisions can be met without serious difficulty in almost every instance.

Cities in Minnesota and the League itself have urged Congress to establish a safe harbor for local government units to assure that cities can comply. For instance, a requirement that such employee benefits would be considered non-discriminatory if the plan offered the same dollar amount on the part of the employer for every city employee would provide such a more simplified and straight-forward approach.

The difficulty with recent proposals such as S. 654 that would exempt employees who work 30 hours or more per week from testing in 1989 is that the temporary and seasonal employees who work more than 17.5 hours per week for more than 6 months a year will have to be included in establishing whether employee benefit plans are available to 90 percent of the employees. That will still cause a problem for many of the smaller cities where part-time employees substantially outnumber the full-time staff.

III. MODIFICATION OF I.R.S. REGULATIONS TO REDUCE ADVERSE IMPACT ON CITIES

A more effective approach is to establish a minimum salary figure such as $52,400, the salary level which defines a highly compensated employee for purposes of Section 89.

Under the present rules, if an employer has no highly compensated employee(s), the highest paid employee must be designated as the highly compensated employee under the plan. In Minnesota, that means that, in hundreds of cases, that individual is going to be a part-time city clerk or administrator, earning less than $20,000 per year.

The exemption for local government and state municipal leagues with no highly compensated employees (defined as $50,000 in 1989, indexed for inflation) would aid all but about 40 cities in Minnesota. Cities over 20,000 population would not be exempt in most cases. Most of those cities are in the Twin Cities metropolitan area; others are regional centers scattered throughout the state.

S. 654 would repeal the rule (Section 414(q)(5)(B) requiring the designation of the highest paid employee as the highly compensated employee in the instance where the city has no highly compensated employees. It is our understanding that the bill would establish that if there are no highly compensated employees, then the city would not have to perform the testing procedures. The League eagerly endorses that approach as one which addresses most directly the situation for many cities in Minnesota.

The alternative provided whereby an employer would not have to perform testing if the health benefits provided were available to at least 90 percent of the employees is helpful up to the point where the requirement specifies that required employee contributions can be no more than $6.70 per week for individual coverage and $13.40 per week for dependent coverage. Although many cities in Minnesota have in the past provided 100 percent coverage for either or both employee and dependent coverage, more recent experience has been for public employers, including cities, to place a cap on the amount of the employer contribution due to the steeply increasing costs of health insurance premiums for employees. As a result, many cities would not be able to qualify under this type of provision.

Making tests easier to comply with is, of course, an appealing and important direction for developing alternatives and modifications of the original Section 89 requirements. Measuring an employer's compliance by plan availability, a design-based test, or by actual plan coverage received by employees may be a useful approach although it may not prevent highly compensated employees from obtaining a more favorable arrangement.

Senator Domenici's proposal to exempt employers with fewer than 20 employees from Section 89 does indeed rescue a number of small businessowners, but for cities, it may only create special treatment for a few cities with small staff complements.

Another proposal in S. 654 would apply the 80 percent alternative coverage test and the 75 percent average benefits test in Section 89 to provide that if a portion of the health care plan that offered individual coverage was available to 80 percent of the city employees or that 75 percent of the employees were elgible for the average benefits available, health care plans that offer individual and dependent care coverage generally would be regarded as non-discriminatory and not have to be separately tested.

While this approach appears to answer the League's concern about health care plans that offer both individual and dependent coverage, if 80 percent of the non-highly compensated employees do not have dependents, they will not elect dependent coverage. At that point, it would appear that such plans would fail the 75 percent average benefit test simply because of the demographics of the work force, not because of any intentional discrimination on the part of the city.

The League favors the section in S. 654 that reworks the current penalty to employees when the failure of the employer to adequately document and communicate with employees about their benefit plans results in tax liability on all employees who use the "discriminatory" benefits. Senator Pryor's approach, namely to limit the penalty to only the employer's cost of the benefit - not the amount of the benefit used, and reserving the tax liability to only highly compensated employees, prevents larger numbers of employees from suffering a tax increase for an error for which they were not at fault.

I will leave you with the words of the city clerk-treasurer in the City of Carlton, Minnesota: population 862. In writing to Senator Boschwitz, Larry Beckstrom commented:

> "Our city has been struggling to make sense of the Section 89 non-discrimination requirements of the 1986 Tax Reform Act. In the process, we have found the mandate to be extremely complex and confusing to the point of being next to impossible to work with.
>
> We in small cities don't have the personel available to spend the significant amount of time that the understanding of this legislation will demand. On this basis, we feel that the legislation should either 1) be simplified and clarified as to be workable; (or) 2) be amended to exclude small cities with few employees,...since we don't generally have any bona fide highly compensated employees according to the definition in the legislation."

Senator **Boschwitz**. We will now turn to—I understand, Ms. Neese, that Senator Boren wants to be here when you testify, so we will now turn to Reed Stigen.

STATEMENT OF REED A. STIGEN, CPA, ON BEHALF OF THE MINNESOTA SOCIETY OF CPAs, MOORHEAD, MN

Mr. **Stigen**. Thank you, Mr. Chairman. This is my first trip to the Hill, and I am pleased to see how intensively you use your facilities here.

I am a CPA who resides in Moorhead, MN. I am testifying on behalf of the Minnesota Society of CPAs. I am a partner in Charles Bailly & Co. We are a regional CPA firm with offices in Minnesota, North Dakota, South Dakota, and Montana. We represent several thousand small businesses in our four-State area.

Section 89 is an incredibly complex and unpopular section of the law. We are already seeing evidence of enforcement problems, companies dropping benefits and substantial administrative costs.

The enforcement problems are going to result because of the attitude of some small business owners. Some resent having the Federal Government tell them how to administer their compensation systems. Some are reacting negatively to the fact that the regulations are incomprehensible.

As an example, a client in the retail business with about 50 employees recently told one of my staff that he had no intention of doing anything with respect to Section 89. He is not going to have us or anyone else determine whether his fringe benefit programs meet the qualification rules, he is not going to spend any money or staff time on testing, and he will continue this practice as long as he can.

This is an example of how one client is reacting, but it is definitely not an isolated case. My partners report similar angry statements by some of their clients. This creates a problem for us as professionals, because if we are aware of non-compliance by a client, we are put in a very delicate and difficult position as CPAs in trying to prepare tax returns or perform audits. In any case, I predict substantial enforcement costs and problems will have to be faced by the Internal Revenue Service if Section 89 is not repealed.

I am also aware of a number of clients who have decided to drop their fringe benefits or have already done so. For example, a client with an office supply store with 30 employees, 20 of whom were covered by a $50 per month group health insurance plan, has dropped the plan. The employees now have no fringe benefits at all. The same thing happened at a drug store and a physician's office.

A construction company client changed their benefit structure on January 1, so that it now requires employees to pay 100 percent of the costs of group plans. It had previously paid for family or single coverage medical insurance depending on the marital status of its employees. A medical clinic dropped the dependent coverage on its group health plan. Section 89 is hurting a lot of innocent employees. It has backfired from its original intended purpose.

The balance of our clients are struggling with trying to determine what to do. For them, Section 89 means spending more money on administration. We estimate that our average small business client will pay us or other outside professionals between $1,000 and $3,000 to look at the documentation on their benefit programs and from $1,500 and up, to perform the non-discrimination tests annually. I have verified that another regional CPA firm agrees with those estimates. Some clients are also buying computer software packages and intend on doing the work internally. A client recently paid $5,000 to acquire one such software package designed to assist with the testing process.

Something must be done. Obviously the popular answer is to repeal Section 89. If that cannot be accomplished because of the need to use Section 89 as a way to produce revenues for the government, then I recommend that you just tax some portion of fringe benefits. At least that would be easier for people to understand.

If repeal of Section 89 is not feasible, we urge that it be substantially simplified and that some mechanism be adopted which will allow employers to avoid the administrative burden imposed by the present law. I ask that you consider the proposal of the American Institute of CPAs which includes several suggested improvements and also proposes a simple alternative whereby small businesses may avoid the complexities of Section 89 altogether. I have submitted the AICPA proposal to accompany my testimony and request that it be included in the official record of this hearing.

One week ago I received a letter asking me, inviting me, to testify here today. I immediately informed my partners throughout the four States that we operate in about this opportunity. Soon many of our clients became aware that I was going to testify. By 10:30 yesterday, when I left the office, our Fax machine was running—as well as the mail and the phone—from clients that had heard about me coming. There are people over and above the ones that I have mentioned who have already dropped plans or are on the verge of dropping plans. And, if time would allow, I would—or let us say if questions are raised with respect to increasing the number of examples we have within our own client base, I would be happy to do so.

Senator BOSCHWITZ. We would like to have those letters and include them in the record if we may. Perhaps you can, when you are done testifying, just pass them up here and we will look at them.

Mr. STIGEN. What I would like to do, since I do not have permission from the individuals to include the letters, is go through them with you. I have a sentence or two that I can quote to reflect what each letter says.

Senator BOSCHWITZ. Fine. Why don't you take a couple of minutes.

Mr. STIGEN. From a construction company in Billings, MT, they are seriously considering abandoning their group benefit programs rather than face the cost. We have a manufacturing company in Brandon, SD. It is having the effect of reducing benefits to workers who badly need them. They are dropping the family coverage. Here we have a proposal from an outside consultant for $7,000 for the first year, the cost of compliance, and $4,000 to $5,000 for years thereafter.

Here we have in Burnsville, MN, an electronics manufacturer who is complaining about the impact this is having, along with the minimum wage increase, in his problems in competing offshore.

Here we have a rubber stamp company in Minneapolis, MN. He cannot interpret the regulations and does not know how he is going to comply with them. This letter says, "We are a construction company in Fargo, ND, that has 30 full-time office, clerical, supervisory, and shop personnel." The company is going to drop coverage on them because of all the craft people they have—in our area of the country, as you know, the construction companies have a lot of people that work 7 months or 8 months a year and, therefore, the cost is prohibitive for them to cover those people with the same plan as they offer their permanent workforce.

Senator BOSCHWITZ. I would say to the Chairman occasionally we have a little cold weather up our way that prevents some of these folks from being outside.

Mr. STIGEN. Here we have a manufacturer in Detroit Lakes, MN, 35 employees, attending numerous seminars and reading many articles. Rather than spending hundreds or thousands of dollars to pay a consultant to perform the tasks, he has opted to decrease the amount of benefits provided to his single hourly employees and all salaried employees. So, he has already done it.

Senator BOSCHWITZ. I would suggest to you that I am sure your clients would not object to this, these things being made part of the record, and I think they would be very valuable additions to the record, and—or you could submit them later when you have obtained permission.

You are the kind of witness who comes from a rural part of Minnesota. Moorhead, Mr. Chairman, is right outside of Fargo and represents clients in three of the four most rural States of the union so why don't you—I think we get the tone of those things—get their permission. We would like to include them. Maybe by the time you get back, there will be more.

Mr. STIGEN. I know that there are. I talked to my secretary when I arrived yesterday and she said there are more coming in.

Senator BOSCHWITZ. Fine. Obtain permission.

Mr. STIGEN. We will do so. I am sure that I can do so. I am sure that they would want me to. It is just that my ethical standards with respect to client confidentiality require me to get permission before I do so.

[The prepared statement of Mr. Stigen follows:]

ORAL TESTIMONY OF REED A. STIGEN, CPA
TO THE SENATE ON SMALL BUSINESS
APRIL 13, 1989

MY NAME IS REED STIGEN. I AM A CPA WHO RESIDES IN MOORHEAD, MINNESOTA AND I AM TESTIFYING ON BEHALF OF THE MINNESOTA SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS. I AM A PARTNER IN CHARLES BAILLY & COMPANY, A REGIONAL CPA FIRM WITH OFFICES IN MINNEAPOLIS, MINNESOTA, FARGO AND BISMARCK, NORTH DAKOTA, SIOUX FALLS, SOUTH DAKOTA AND BILLINGS MONTANA. WE REPRESENT SEVERAL THOUSAND SMALL BUSINESSES IN OUR FOUR-STATE PRACTICE AREA.

SECTION 89 IS AN INCREDIBLY COMPLEX AND UNPOPULAR SECTION OF THE LAW. WE ARE ALREADY SEEING EVIDENCE OF ENFORCEMENT PROBLEMS, COMPANIES DROPPING BENEFITS AND SUBSTANTIAL ADMINISTRATIVE COSTS.

THE ENFORCEMENT PROBLEMS ARE GOING TO RESULT BECAUSE OF THE ATTITUDE OF SOME SMALL BUSINESS OWNERS. SOME RESENT HAVING THE FEDERAL GOVERNMENT TELL THEM HOW TO ADMINISTER THEIR COMPENSATION SYSTEMS. SOME ARE REACTING NEGATIVELY TO THE FACT THAT THE REGULATIONS ARE INCOMPREHENSIBLE. AS AN EXAMPLE, A CLIENT IN THE RETAIL BUSINESS WITH ABOUT 50 EMPLOYEES RECENTLY TOLD ONE OF MY STAFF THAT HE HAD NO INTENTION OF DOING ANYTHING WITH RESPECT TO SECTION 89. HE IS NOT GOING TO HAVE US OR ANYONE ELSE DETERMINE WHETHER HIS FRINGE BENEFIT PROGRAMS MEET THE QUALIFICATION RULES, HE IS NOT GOING TO SPEND ANY MONEY OR STAFF TIME ON TESTING AND HE WILL CONTINUE THIS PRACTICE AS LONG AS HE CAN. THIS IS AN EXAMPLE OF HOW ONE CLIENT IS REACTING, BUT IT IS DEFINITELY NOT

AN ISOLATED CASE. MY PARTNERS REPORT SIMILAR ANGRY STATEMENTS BY SOME OF THEIR CLIENTS. THIS CREATES A PROBLEM FOR US AS PROFESSIONALS, BECAUSE IF WE ARE AWARE OF NON-COMPLIANCE BY A CLIENT, WE ARE PUT IN A VERY DELICATE AND DIFFICULT POSITION AS CPAS IN TRYING TO PREPARE TAX RETURNS OR PERFORM AN AUDIT. IN ANY CASE, I PREDICT SUBSTANTIAL ENFORCEMENT COSTS AND PROBLEMS WILL HAVE TO BE FACED BY THE INTERNAL REVENUE SERVICE IF SECTION 89 IS NOT REPEALED OR SUBSTANTIALLY SIMPLIFIED.

I AM ALSO AWARE OF A NUMBER OF CLIENTS WHO HAVE DECIDED TO DROP THEIR FRINGE BENEFITS OR HAVE ALREADY DONE SO. FOR EXAMPLE, A CLIENT WITH AN OFFICE SUPPLY STORE WITH 30 EMPLOYEES, 20 OF WHOM WERE COVERED BY A $50.00 PER MONTH GROUP HEALTH INSURANCE PLAN, HAS DROPPED THE PLAN. THE EMPLOYEES NOW HAVE NO FRINGE BENEFITS AT ALL. THE SAME THING HAPPENED AT A DRUG STORE AND A PHYSICIAN'S OFFICE. A CONSTRUCTION COMPANY CLIENT CHANGED THEIR BENEFIT STRUCTURE ON JANUARY 1 SO THAT IT NOW REQUIRES EMPLOYEES TO PAY 100% OF THE COSTS OF GROUP PLANS. IT HAD PREVIOUSLY PAID FOR FAMILY OR SINGLE COVERAGE MEDICAL INSURANCE DEPENDING ON THE MARITAL STATUS OF ITS EMPLOYEES. A MEDICAL CLINIC DROPPED THE DEPENDENT COVERAGE ON ITS GROUP HEALTH PLAN. SECTION 89 IS HURTING A LOT OF INNOCENT EMPLOYEES. IT HAS BACKFIRED FROM ITS ORIGINAL INTENDED PURPOSE.

THE BALANCE OF OUR CLIENTS ARE STRUGGLING WITH TRYING TO DETERMINE WHAT TO DO. FOR THEM, SECTION 89 MEANS SPENDING MORE MONEY ON ADMINISTRATION. WE ESTIMATE THAT OUR AVERAGE SMALL

BUSINESS CLIENT WILL PAY US OR OTHER OUTSIDE PROFESSIONALS BETWEEN $1000 AND $3000 TO LOOK AT THE DOCUMENTATION ON THEIR BENEFIT PROGRAMS AND FROM $1500 AND UP TO PERFORM THE NON-DISCRIMINATION TESTS ANNUALLY. I HAVE VERIFIED THAT ANOTHER REGIONAL CPA FIRM AGREES WITH THOSE ESTIMATES. SOME CLIENTS ARE ALSO BUYING COMPUTER SOFTWARE PACKAGES AND INTEND ON DOING THE WORK INTERNALLY. A CLIENT RECENTLY PAID $5000 TO ACQUIRE ONE SUCH SOFTWARE PACKAGE DESIGNED TO ASSIST WITH THE TESTING PROCESS.

SOMETHING MUST BE DONE. OBVIOUSLY THE POPULAR ANSWER IS TO REPEAL SECTION 89. IF THAT CANNOT BE ACCOMPLISHED BECAUSE OF THE NEED TO USE SECTION 89 AS A WAY TO PRODUCE REVENUES FOR THE GOVERNMENT, THEN I RECOMMEND THAT YOU JUST TAX SOME PORTION OF FRINGE BENEFITS. AT LEAST THAT WOULD BE EASIER FOR PEOPLE TO UNDERSTAND.

IF REPEAL OF SECTION 89 IS NOT FEASIBLE, WE URGE THAT IT BE SUBSTANTIALLY SIMPLIFIED AND THAT SOME MECHANISM BE ADOPTED WHICH WILL ALLOW EMPLOYERS TO AVOID THE ADMINISTRATIVE BURDEN IMPOSED BY THE PRESENT LAW. I ASK THAT YOU CONSIDER THE PROPOSAL OF THE AMERICAN INSTITUTE OF CPAS WHICH INCLUDES SEVERAL SUGGESTED IMPROVEMENTS, AND ALSO PROPOSES A SIMPLE ALTERNATIVE WHEREBY SMALL BUSINESSES MAY AVOID THE COMPLEXITIES OF SECTION 89 ALTOGETHER. I HAVE SUBMITTED THE AICPA PROPOSAL TO ACCOMPANY MY TESTIMONY AND REQUEST THAT IT BE INCLUDED IN THE OFFICIAL RECORD OF THIS HEARING.

THANK YOU FOR THIS OPPORTUNITY TO PROVIDE TESTIMONY ON BEHALF OF MY SMALL BUSINESS CLIENTS.

Statement of the
Federal Taxation Division
# of the
American Institute of Certified Public Accountants

To Accompany Testimony of

Reed A. Stigen, CPA
Minnesota Society of CPAs

Before the Committee on Small Business
of the United States Senate

Hearing on the

Impact of IRC Section 89 on Small Business

April 13, 1989

American Institute of Certified Public Accountants
1455 Pennsylvania Avenue, NW
Washington, DC 20004
(202) 737-6600

Introduction

The American Institute of Certified Public Accountants ("AICPA") appreciates this opportunity to offer its comments on the impact of Section 89 on small business. The AICPA is the national, professional organization of CPAs, with over 280,000 members. Many of our members are tax practitioners who work with millions of American taxpayers: individual and business. We are deeply concerned with the impact of Section 89 upon businesses of all sizes, in all sectors of the economy.

In particular, small businesses are encountering many problems with the new benefit rules. We have received hundreds of calls from CPAs requesting assistance in interpreting Section 89 for their clients. Many of our members report that their clients, both small and large, are finding the statute too complicated to interpret and too expensive to administer. Some small businesses are even considering the possibility of eliminating some or all benefit plans in order to avoid the complexities of Section 89.

For example, as Reed A. Stigen, CPA stated in his oral remarks at this hearing on behalf of the Minnesota Society of CPAs:

- An office supply store with 30 employees, 20 of whom were covered by a group health insurance plan which has an employer provided benefit of $50.00 per month, has dropped the plan.
- A construction company changed its benefit structure on January 1 so that it now requires employees to pay 100 percent of the cost of health plans.
- A medical clinic dropped the dependent coverage on its group health plan.

Section 89 is hurting a lot of innocent employees. While it is arguable as to the appropriateness of these reactions, the bottom line effect is clearly not in doubt. Many workers are losing benefits because of Section 89.

Large employers also incur an extremely large cost in complying with Section 89. One employer, a Fortune 100 company with 45,000 employees in 2,000 locations must test approximately 300 plans under Section 89. As a result of the test, their approximately 1,500 employees will recognize additional income of approximately $650,000. To calculate the additional income to be recognized, the employer has incurred additional consulting fees of $260,000 through December 31, 1988. This does not include the additional costs incurred within the corporation in compiling the data.

Annual expected cost to the employer for testing documentation and maintenance of compliance is $250,000. No new or increased health benefits were provided to employees since the cost of doing this would far exceed the additional burden employees bear with respect to this additional income.

The complexity of these rules has resulted in widespread misunderstanding of the provisions which will lead to growing enforcement problems for the Internal Revenue Service. Section 89 is a good example of the inevitable linkage of complexity and noncompliance.

In November, we mailed to our 22,000 Tax Division members a copy of our 15-page practice guide which focused on the small business entity which has only one employee plan; thus, it did not encompass most of the complexities of Section 89 which are proving to be literally unworkable. Even in the relatively simple situation described in our practice guide, there were many questions which remained unanswered due to the absence of regulations or other guidance from the IRS or Treasury.

Comments on IRS Proposed Regulations to Section 89

The IRS issued proposed regulations in March. They are long (40 pages in the Federal Register) and most early assessments indicate that they are quite confusing. The proposed regulations do answer many questions, include transitional relief, and offer a number of new testing alternatives. At the same time they have increased considerably the complexity of Section 89.

Many of the proposed regulations' provisions will ease compliance with Section 89. We especially applaud the Internal Revenue Service on these rules:

- Up to six-month data gathering delay for accident or health plans (but not other plans);
- A delay until July 1, 1989 to satisfy the "notice" requirement;
- One-year delay for satisfying most of the other qualification requirements of Section 89(k);
- Correction period allowed for de minimis errors in the written plan or notification requirement;
- Adjustment of the maximum penalty for IRC Section 89(k) violation to income levels of the employee;
- Election to use the 80 percent coverage test for calculation of the discriminatory excess rather

than requiring computation of discriminatory excess under the eligibility and benefits tests; and

- Special "large employer" design based rule that provides alternative tests for governments and other large employers with relatively low numbers of highly-compensated employees.

Specifically, we take issue with the following items in the regulations:

- Adding the 50 percent test as a separate step before two plans can be aggregated for the 80 percent test;
- Not delaying the effective date of Section 89 for group term life insurance;
- A nonuniform transition period for Section 89(k);
- Limiting the rule for defining certain material terms based on an insurance company's usual practice to insured plans;
- Lack of guidance on how and when withholding and employment taxes should be applied to the discriminatory excess;
- No clarification of whether a testing date is fairly representative before or after taking into account the excludible employee rules of Section 89(h);
- Lack of guidance on separate line of business rules; and
- A presumption that alternative valuation methods are invalid if relative values of plans deviate significantly from relative values of cost-based valuation.

The IRS estimates the total annual reporting and/or recordkeeping burden to be 9 million hours. Among tax professionals, this statistic is viewed as no closer than 25 percent of the likely reality. Donald Lubick, former Assistant Secretary for Tax Policy (Treasury) in the Carter Administration, asserts that even taking that estimate at an inconceivably low average cost of $30.00 per hour, an annual compliance cost of $270 million compares with the 1986 Act estimate of revenue to be derived from Section 89 of $72 million for fiscal 1988, $120 million for fiscal 1989, $140 million for fiscal 1990 and $154 million for fiscal 1991. The most conservative projected annual cost of compliance exceeds the enactment revenue raising estimates by more than double!

The IRS also indicates that the time needed to learn about the law, to test and make a written election, and the annual recordkeeping burden will vary from 1 to 40 hours depending on the individual circumstances with an estimated average of 10 hours. This estimate is definitely too low. Section 89 consultants have stated that in actuality, briefing professionals on the generalities of the statute may take 40 hours at a minimum, but the average is certainly much higher.

AICPA Proposal

Section 89 was intended to discourage employers from offering health plans and other welfare benefits that disproportionately favored highly-compensated employees either as to coverage or extent of benefits. A principal objective was to extend health coverage for employees not now covered. It is debatable as to whether this objective has been met.

In recent months, the AICPA has been working with members and staff of the House Ways and Means and Senate Finance Committees to simplify Section 89 and formulate alternatives. As a result of these discussions the AICPA has developed an alternative which would enable employers to avoid Section 89 entirely if their higher paid employees report some or all of their health care premium as income. The AICPA has also endorsed, in concept, S.654, introduced by Senator David Pryor (D.,AR) to simplify Section 89; endorsed, in concept, simplification ideas being discussed by the Section 89 Coalition; and proposed additional simplification measures to Section 89 not included in the above two simplification proposals.

Specifically, the AICPA alternative recommends that a companion section (e.g. 89A) be adopted which would allow employers to avoid Section 89 entirely (other than the qualification provisions). Thus, Section 89 (as modified below) would be available to all employers, but an alternative would also be available to all employers who are willing to impute income to employees earning more than a specified amount. The principal characteristics of such an alternative can be summarized as follows:

1. Define highly-compensated (HCE) and nonhighly-compensated (NHCE) employees on the basis of the W-2 wage before imputation of income, rather than going through the identification procedures of Section 414(q) as required by Section 89. We suggest that the breaking point be $50,000 (COLA indexed) in order to

parallel the present Section 414(q)(1)(C). This is $54,480 for 1989. The testing could be done based on the Form W-2 for the tax year that begins with or within the plan year prior to the imputation of income for this section. An election to delay inclusion similar to Section 89(a)(2)(B) could also be used.

2. Require the employer to impute income to the HCEs as follows:

   a. Impute 100 percent of the cost relative to HCEs, or

   b. Impute a percent (perhaps 20 percent) of the cost relative to HCEs, provided there are at least three times as many NHCEs eligible for the plan as there are HCEs. Alternatively, this eligibility test could be satisfied with a ratio test similar to that in Section 89(d)(2). If the plan is contributory, such contribution for the NHCE must not exceed the lesser of X percent (in the 4 percent range) of Form W-2 wages, or Y percent (perhaps 20 percent) of the premium cost.

This alternative would be of interest to the thousands of employers who are fairly certain that if they run the Section 89 tests, they will have to impute income to their HCEs, and would rather accept that conclusion without the cost and inconvenience of gathering the data and making all the difficult and time-consuming Section 89 calculations.

We believe our alternative has several advantages. These include:

- True simplification for the entity.
- More revenue for the government because more entities may be likely to impute income to highly-compensated employees.
- Some entities will be motivated to cover more nonhighly-compensated employees in order that the highly-compensated employees can recognize lesser amounts in income.
- Highly-compensated and nonhighly-compensated employees are easily identified.
- For most entities there will be no need to count total employees, including part-time or leased employees.

- Section 89 will remain in place and will be available for those entities which elect to use it.

Inasmuch as Section 89 will remain in place, it is important to improve and simplify it to the extent feasible. Toward this end, the AICPA supports the following provisions:

1. Section 89 rules need not apply to group term life insurance:

   Maintain the IRS Section 79 discrimination rules for group term life insurance. Eliminate the classification of group term life insurance as a statutory benefit under Section 89(i)(1). (AICPA proposal)

2. Repeal Section 89(k)(1)(D), the "exclusive benefit rule":

   Individuals without a service nexus would be allowed to be covered by a plan. Alternatively, the "exclusive benefit rule" could be retained, but amended, to allow up to 10 percent of the individuals covered by a plan to be without a service nexus. In either case, those without a service nexus would receive no tax subsidy, i.e., the full cost of the coverage would be paid from "after-tax" dollars. This is important for many closely-held business plans which include nonemployees. (AICPA proposal)

3. Avoid separate testing for dependent coverage:

   A plan which provides employee-only coverage and dependent coverage will be treated as a single plan for testing purposes, provided that dependent coverage is available to NHCEs on the same basis as to HCEs. To be eligible for this rule, the benefit must not cost the individual NHCE more than the lesser of X percent (in the 4 percent range) of Form W-2 wages, or Y percent (20 percent) of the premium cost. (AICPA proposal)

4. Simplified Health Arrangements:

   An employer who satisfies standards for a model simplified health arrangement is allowed to forgo Section 89(a-j) tests (new Code Section 90). To qualify for this safe harbor provision, an employer's health plan would have to be available to 90 percent of its employees, and mandatory employee contributions would be limited. For employee-only coverage, the employee contribution could not exceed $6.70 per week, and for coverage extending to dependents of an employee, the employee contribution could not exceed $13.40 per week. (Pryor bill)

5. Elimination of the 90/50 Test:

   The existing 90/50 test and related provisions of Section 89 would be eliminated. (Section 89 Coalition)

6. Income Inclusion for Certain Failures Only to Apply to Highly-Compensated Employees:

   If a plan fails the qualification requirements, only highly compensated employees would have to include in taxable income only the full value (COBRA cost) of the insurance coverage. (Pryor bill)

7. Lack of Highly-Compensated Employees:

   If there are no highly-compensated employees, then employers do not have to do the Section 89 testing. (Pryor bill)

8. Deemed Coverage Rule:

   Nonhighly-compensated employees would be treated as receiving the value of any accident or health coverage offered to them that requires employee contributions of less than one-third of the coverage's cost. In applying this rule, an employer could elect to treat employee-only coverage and dependent coverage as a single coverage. (Section 89 Coalition)

9. Aggregation Rule:

   For purposes of the 80 percent rule, two or more accident or health plans are treated as comparable and therefore, can be aggregated for testing purposes if (1) such plans are available to all employees within the group on the same terms, and (2) the difference in annual employee cost between the plans in the group with the smallest and largest employee costs is no more than $365 (indexed). In order to apply this safe harbor, employee contributions must be made on the same pre- or post-tax basis. (Pryor bill)

10. Phase-in Testing of Part-Time Employees:

    Part-time would be defined as under 30 hours per week for the first year, under 28 1/2 hours per week for the second year, and under 25 hours per week for all years thereafter. (Section 89 Coalition)

11. Valuing Coverage:

Employers are allowed to use any reasonable method for valuing a health plan. (Pryor bill)

12. Leased Employees:

Until testing years beginning after the later of 1990, or six months following the release of final regulations relating to leased employees, the leased employee rules generally would not apply for purposes of Section 89. This delay, however, would not apply to an employer that is primarily engaged in the delivery of professional services. (Section 89 Coalition)

13. Former Employees:

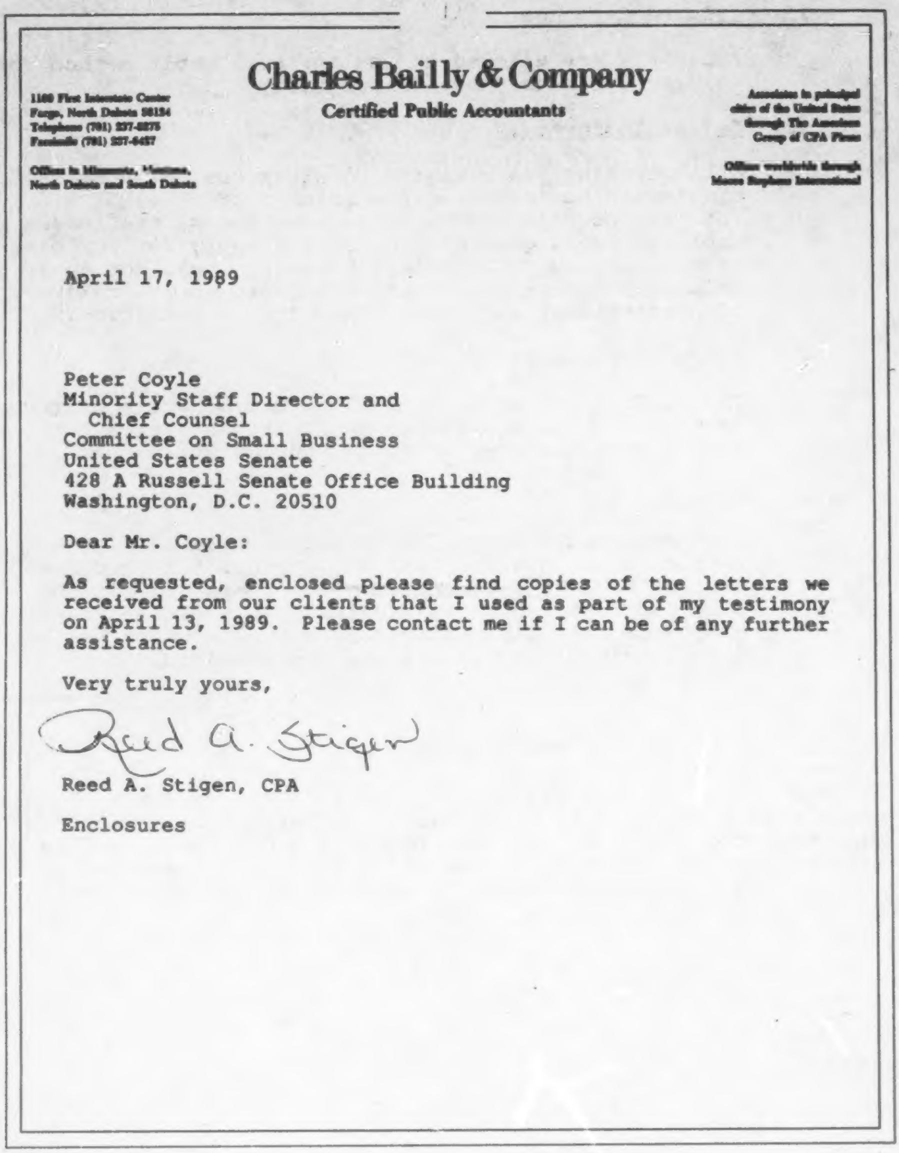
The application of Section 89 to the benefits of former employees would be delayed until testing years beginning after 1990. (Section 89 Coalition)

14. Time for Testing:

The tests would be applied based on data as of the testing date. The current adjustments for enrollment changes by highly-compensated employees and changes in plan design would be eliminated. In addition, the choice of a testing date would not be subject to the "nondiscriminatory provisions requirements." (Pryor bill)

Conclusion

In view of the burdens placed on practitioners and small businesses by Section 89, legislative relief is called for. We hope that the Committee will consider the AICPA's proposal in modifying the existing law. The AICPA will be pleased to continue working with Congress to accomplish its objectives.



Charles Bailly & Company
Certified Public Accountants

1100 First Interstate Center
Fargo, North Dakota 58124
Telephone (701) 237-5575
Facsimile (701) 237-6457

Offices in Minnesota, Montana,
North Dakota and South Dakota

Associates in principal
cities of the United States
through The American
Group of CPA Firms

Offices worldwide through
Moore Stephens International

April 17, 1989

Peter Coyle
Minority Staff Director and
Chief Counsel
Committee on Small Business
United States Senate
428 A Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Coyle:

As requested, enclosed please find copies of the letters we received from our clients that I used as part of my testimony on April 13, 1989. Please contact me if I can be of any further assistance.

Very truly yours,

Reed A. Stigen

Reed A. Stigen, CPA

Enclosures

APR 12 '89 08:02 BH ELECTRONICS MPLS MN 55337 USA P.1

BH Electronics

BH Electronics, Inc.
12219 Wood Lake Drive
Burnsville, MN 55337
U.S.A.

TELEPHONE (612) 894-9590
FAX (612) 894-9380

April 11, 1989

Reed Stigen
Charles Bailly And Company
Fargo, ND
FAX (701)237-6427

I read with great interest your invitation to testify before the U.S. Senate Small Business Committee with respect to Section 89 of the Internal Revenue Code.

(Section 89)

Very briefly, we are a small manufacturing company employing 150 Minnesotans of which all but 7 employees are employed in rural areas. We have not yet analyzed how Section 89 affects BH, however we are certain it will have a negative impact after testing is completed. Our competition is about 85 percent from offshore, mostly FAR EAST sources. This, combined with the pending increase to minimum wages, will certainly create additional hardship on already eroding profit margins.

Without having gone through the testing process and therefore not knowing how disastrous it will be to BH, we feel we will have 2 alternatives:

1) Eliminate all health insurance and benefit plans for all employees and give each employee a one-time gross up in wages thereby allowing them to fend for themselves for H and W plans or,

2) Gross up highly compensated employees while reporting the difference on their W-2's.

In the meantime, we are hoping legislators will realize the negative impact Section 89 has had on all the U.S. employees who have already lost their benefit packages because employers are "Fed UP" with government intervention, unnecessary paperwork and legal mumbojumbo. We are hoping Section 89 will be abandoned entirely and we can go back to running prudent businesses.

Sincerely,

Katherine M. Space

Katherine M. Space
Vice President

CC: Bob Campbell

OGEMA STATE BANK TEL NO.218-983-3243 APR.11.89 11:17 P.01

OGEMA STATE BANK

OGEMA, MINNESOTA

April 11, 1989

Reed Stigen
Charles Bailey & Company
110 First Interstate Center
Fargo, ND 58124

Dear Mr. Stigen,

RE: Comment on SEction 89 [illegible]

Direct effect of Section 89 in this bank relates to the provision requiring Health Insurance Benefits to be provided to employees who work more than 17 hours per week.

We presently have an employee that works and with her filling in for vacationing full time employees would average 19 to 20 hours per week during a years time.

As you can see from the enclosed copy or the bank's group insurance, average cost per employee is $ 360.00. Should we be required to provide insurance the additional cost is as follows:

80 Hours @ 4.50/ hour wage (20 hours per week)	360.00 / Month
Health Insurance	360.00 / Month
$ 9.00 per hour employee cost.	720.00

At present the solution is to cut back on the number of hours this employee works in order to be below the 17 hours per week or to hire an additional part time person to share the hours. Neither solution would be appreciated by the part time person or management.

Sincerely,

Michael D. Coalwell
President

MONTHLY STATEMENT

[illegible]	MEMBER'S REFERENCE NUMBER	PAGE
4/01/89	22-0645	1

IBAA GROUP INSURANCE PROGRAMS
303 E ARMY TRAIL, BOX 730
BLOOMINGDALE, IL 60108-0730
CALL TOLL FREE 800-323-6898
IN ILLINOIS CALL: 800-843-4643

EMPLOYEE COMPANY NUMBER	EMPLOYEE NAME	CHANGE DATE	PREMIUM ADJUSTMENTS	MONTHLY PREMIUM	$ BENEFIT IN THOUSANDS	PREMIUM	TYPE*	PREMIUM	TYPE*	PREMIUM	TYPE*	PREMIUM
	CARLSON DUANE A 471482350			352.87	30.00 30.00	8.40 1.80		.83		133.07 208.77		
	CASPERS MILDRED M 470545847			503.97	22.50 22.50	22.73 1.35		.83		270.29 208.77		
	COALWELL MICHAEL D 471585970			324.37	33.00 33.00	5.28 1.98		.83		107.51 208.77		
	INGEBRIGTSON MARY E 474620615			307.31	16.50 16.50	2.15 .99		.83		94.57 208.77		

Mathiowetz Construction Co.

ROAD CONTRACTING & DITCHING

SLEEPY EYE, MINN. 56085

Located at Leavenworth
9½ miles SE of Springfield
8 miles SW of Sleepy Eye

Telephone:
Sleepy Eye (507) 794-[illegible]
FAX No. 507-794-[illegible]

April 13, 1989

U.S. Senate Small Business Committee

The Mathiowetz Construction Company is hereby strongly opposed to the Section 89 legislation and we feel it MUST either be modified or repealed for small businesses like us.

The amount of time, money, effort, paperwork, consultant and lawyer fees are overwhelming. It makes us wonder if this unnecessary burden on business is worth the ramifications.

The Section 89 legislation as it now stand is worse than a direct tax increases.

We are already in compliance with Section 89 but it will cost us up to $10,000 to prove it. Please consider this.

Sincerely,
Mathiowetz Construction Company

Richard J. Mathiowetz

Richard J. Mathiowetz
President

RJM:cam

89. 02/14 09:17 P02 *BURROUGHS SERVICE MPLS MN

GNDA
Greater North Dakota Association

April 12, 1989

Mr. Reed Stigen
Charles Bailly & Company
100 First Interstate Center
Fargo, ND 58124

Dear Sir:

The Greater North Dakota Association, North Dakota's State Chamber of Commerce, supports S. 634 a bill to repeal Section 89 of the Internal Revenue Code.

Section 89 places health and benefit plans at risk, imposes an enormous paperwork and financial burden on employers, is a back door to taxation of employee benefits which harms employers and employees alike and is an additional mandated benefit on employers.

The Greater North Dakota Association strongly urges the repeal of Section 89.

Sincerely,

Dale O. Anderson
President

DOA/jle

Box 2467 • 808 Third Ave. S. • Fargo, ND 58108 • (701) 237-9461
Box 2639 • 425 7th St. • Bismarck, ND 58502 • (701) 222-0929
North Dakota's State Chamber of Commerce

BISMARCK TOOL and DIE COMPANY
1050 13th Avenue South East
P.O. Box 1107
Detroit Lakes, Minnesota 56501
218-847-4446

April 10, 1989

Charles Bailly & Company
1100 First Interstate Center
Fargo, ND 58124

Dear Charles Bailly & Company:

Thank you for the opportunity to provide you with comments concerning Section 89 to support your testimony to the U.S. Senate.

Bismarck Tool and Die Company has been in business ten years and presently employes 35 employees. We provide a health benefit plan to our employees and are very concerned about to impact of Section 89 on our plan.

After attending numerous seminars and reading many articles and publications, I still don't understand fully how to apply the complicated compliance tests contained in Section 89 to our situation. Rather than spent hundreds or more likely thousands of dollars to pay a consultant to preform the compliance tests, our company has opted to decreases the amount of benefits provided to our single hourly employees and all salaried employees. In addition we will W-2 a portion of the employee-owners premiums. As we are a small privately owned company that has reinvested every dollar of earning back into the business we have no highly compensated employees. Unfortunately Section 89 requires us to treat the owners as highly compensated, not because of their income but simply the fact that they are owners.

Section 89 is obviously intended to raise revenue and it no doubt will succeed on one hand, but it will cost our company plenty, and in our tax bracket we will reduce our federal tax liability by 39% of our compliance costs.

In conclusion, I find it very difficult to accept the fact that congress can not live with a budget and feels compelled to raise taxes via Section 89, demonstrating a lack of courage to call it a tax increase, but has opted to put a demand on the resources of American companies that ultimately diminish a companies ability to work efficiently and competitively in a world market.

Sincerely,

DWalte
D. A. Welte
Controller
Bismarck Tool and Die Company

APR 12 '89 07:57 COP P.1/1

COP CONSTRUCTION CO.
General Contractors
AN EQUAL OPPORTUNITY EMPLOYER
P.O. BOX [illegible]
PHONE [illegible]
FAX [illegible]
BILLINGS, MONTANA [illegible]

April 12, 1989

Reed Stigen
Managing Partner of Charles Bailly & Co.
FAX #: 701-237-6427

Dear Reed:

Section 89 must be repealed! Small businesses, such as ours, are becoming completely swamped to the point of paralysis by the ever growing flood of federally mandated requirements. Section 89 is another terrible example of a well intentioned concept that generates a negative result.

I believe in providing significant and valuable compensation and benefits to my employees; and I do. I believe in providing compensation and benefits that will attract and retain valuable employees; and I do. I do not believe in the government dictating to me how to do this.

The time and expense required to review and comply with Section 89 is going to come right out of the financial resources of our company and each and every one of our employees. We are seriously considering abandoning our benefit program rather than face the costs associated with the review, compliance, and penalties of Section 89.

Our company does not have the luxury to divert our meager resources to address social concern that interest parties that are not involved in our daily struggle for financial survival. What we need are fewer rules and regulations on how to run our company. We are willing to put our personal assets, our time, and our efforts into a business venture. We realize that quick fortunes are rare; we are satisfied with a fair profit for a fair effort. However, we are almost to the point of saying "enough is enough".

Sincerely,
COP Construction Co.

John L. Hansen

John L. Hansen, Jr.
President

JLH:sd

04/12/89 09:07 ☎ 701 293 7426 T.F.POWERS CONST 02

T. F. Powers Construction Co.
P.O. BOX 2038 910 SIXTH AVENUE NORTH FARGO, NORTH DAKOTA 58107

MEMO TO: CHARLES BAILLY & CO.

FROM: JOHN A. ADAMS

DATE: APRIL 10, 1989

TO WHOM IT MAY CONCERN:

After considerable time spent reviewing qualification rules for Section 89 of the Internal Revenue Code I have come to the following conclusion:

It is the intent of this company to cancel its health care plan and its group term life insurance plan simply because it is so cumbersome to go through the qualification rules of which I am not sure I understand fully.

We are a construction company doing approximately $7,000,000 - $10,000,000 worth of work in place per year. The people involved in any benefit program are our salaried people and they number between 8-10. As of this date the company has terminated its profit sharing plan because of the Tax Reform Act of 1986 and unless Section 89 of the Internal Revenue Code is repealed or at least simplified this company will have no choice but to terminate the benefits covered by Section 89.

Being a construction company our number of hourly employees fluctuates from a few people to 50-60 people. Inhere lies the problem with Section 89 of the Internal Revenue Code.

OFFICE: (701) 293-1312 / FAX LINE: (701) 293-7426

ODNEY ADVERTISING AGENCY
P.O. BOX [illegible] • 120 3RD STREET • BISMARCK, ND [illegible] • TELEPHONE (701) [illegible]

TO: 701 237-6427

DATE: 3/10 TIME: 3:20 pm

TO: Reed Stigen
Charles Bailey & Company

FROM: JIM ODNEY

MEMO: As your request regarding Section 89, I've enclosed a letter I sent to Byron Dorgan and his reply. He also sent the Conference report on this legislation which I'm sure you have.

Jim Odney

FAX: (701) 258-0218

04/18/89 16:55 ☎ 701 224 8555 CBCO BIS 02

ODNEY ADVERTISING AGENCY

December 22, 1988

Byron Dorgan
U. S. Congress
P. O. Box 2579
Bismarck, ND 58502

Dear Byron:

I'm writing to express my concern regarding recent legislation which could have a very negative impact on business.

As I understand it, section 89 requires that employers offer equal benefits to all employees. It would seem that fringe benefits should be treated as regular compensation in that certain employees are entitled to certain things based on experience, talent, education, time with company, etc. If it is fair to offer equal benefits, perhaps it is also fair to offer equal salary to all employees. Section 89 is about as ridiculous.

Byron, I have a tremendous amount of respect for you. I consider you one of the few who does what is right working for North Dakota and not just for special interest or persons of your own political party. Even though this is not a partisan issue, rescinding this measure would be the right thing to do. My small business can't afford this kind of legislation and it would be unfair to my key employees who are dedicated, hard working individuals who make my business what it is to reduce their health care and other fringe benefits.

Thank you for your consideration. I know you'll do what is best for all parties concern.

Sincerely,

ODNEY ADVERTISING AGENCY

Jim Odney

dp:JO

120 THIRD STREET • P.O. BOX 2035 • BISMARCK, NORTH DAKOTA 58502 • (701) 222-8721

BYRON L. DORGAN
NORTH DAKOTA

[illegible]
[illegible]
[illegible]

WAYS AND MEANS COMMITTEE
SUBCOMMITTEE
OVERSIGHT
SELECT REVENUE MEASURES

Congress of the United States
House of Representatives
Washington, DC 20515

[illegible]

January 19, 1989

Mr. Jim Odney
Odney Advertising Agency
P.O. Box 2035
Bismarck, North Dakota 58502

Dear Mr. Odney:

Thank you for contacting me to express concern over the "Section 89" nondiscrimination rules that were contained in the 1986 Tax Reform Act.

A good deal of confusion among members of the business community still exists because of the failure of the IRS to issue its regulations on implementing this section of the tax reform statute in a timely fashion. The regulations were to go into effect on January 1, but the November 15, 1988, deadline for announcing the final rules is long past, and steep penalties will go into effect even for those businesses that make a good-faith effort to interpret the law without the benefit of federal guidelines.

There is a movement underfoot to get Congress to repeal these regulations on the grounds that they are too complex and too costly. At this time, there is little interest among congressional leaders to revisit the topic. For one thing, Congress did incorporate language in the 1988 technical corrections tax bill to simplify the rules for Section 89. Nevertheless, there is growing support for changes in these rules, and I for one will be working for further simplification of Section 89 so that compliance will not be the "nightmare" that it now is.

In the meantime, I am enclosing the explanation of the changes for Section 89 that were incorporated in Tax Reform Act of 1986 and the changes made in the 1988 technical corrections statute. If you have any questions regarding these, please let me know.

I appreciated your getting in touch with me about this, Mr. Odney, and if you have further comments, don't hesitate to contact me again.

Sincerely,

Byron L. Dorgan
Member of Congress

BLD:smo
Enclosures

THE THOMAS AGENCY, LTD.

Laurence P. Sullivan, JD.
General Manager
Janice E. Thompson
Office Manager
Celia R. Anderson, FLMI
Group insurance Specialist

Frank E. Thomas, CLU
Agent Emeritus

April 10, 1989

Reed Stigen, CPA
Charles Bailly & Co.
800 First Interstate Center
Fargo, ND 58124-0001

Dear Reed:

The Thomas Agency, Ltd. has been active in the group life insurance market for many years. We have numerous clients ranging in size from 5 person corporations to corporations with thousands of employees. In attempting to familiarize ourselves with Section 89 we have spent literally hundreds of hours working on examples, attending seminars and reading and studying bulletins, articles and regulations.

As an attorney who previously specialized in the employee benefits area, I now feel that I have a working knowledge of Section 89 and its implications. For a small corporation, the amount of time required to become knowledgeable in this area is prohibitive. Most companies need to rely on their advisors for help. For large corporations, the amount of man hours spent in testing, retesting, gathering information and sending people to school will be horrendous. For small companies the costs can be prohibitive.

EXAMPLE

I have reviewed the implications of having a discriminatory plan under Section 89. Under the old law "Section 79" anyone receiving more than $50,000 of life insurance coverage as a group benefit, was taxed on the coverage over $50,000. Under the new law you must calculate that tax and then calculate an additional tax after determining what the "discriminatory excess" is. This calculation is extremely complicated. Few, if any, corporations will be able tocomplete the calculation on their own. It will be necessary to hire professionals who specialize in the area to do the testing and calculations. Based on the sample test and calculations that we have run it is our opinion that the amount of revenue generated for the government will be insignificant in comparison to the amount of man hours and dollars spent by the business community in attempting to comply with this legislation. Once again the government has passed a bureaucratic nightmare on to the public under the guise of protecting the average worker. The opposite is actually happening, many companies will do away with their plans rather then go through the expensive and complicated calculations necessary to comply. I urge repeal of Section 89 in its entirety. If that is an impossibility, Section 89 should be modified so that the calculations for determining taxable income become simplified. Why not just tax the "highly compensated employees" on the entire amount of their coverage based on the old Table 1 rates. This cuts out the $50,000 tax free benefit for those plans that elect to stay discriminatory and it also simplifies the over-all calculation to a point where the average bookkeeper can continue making the calculations.

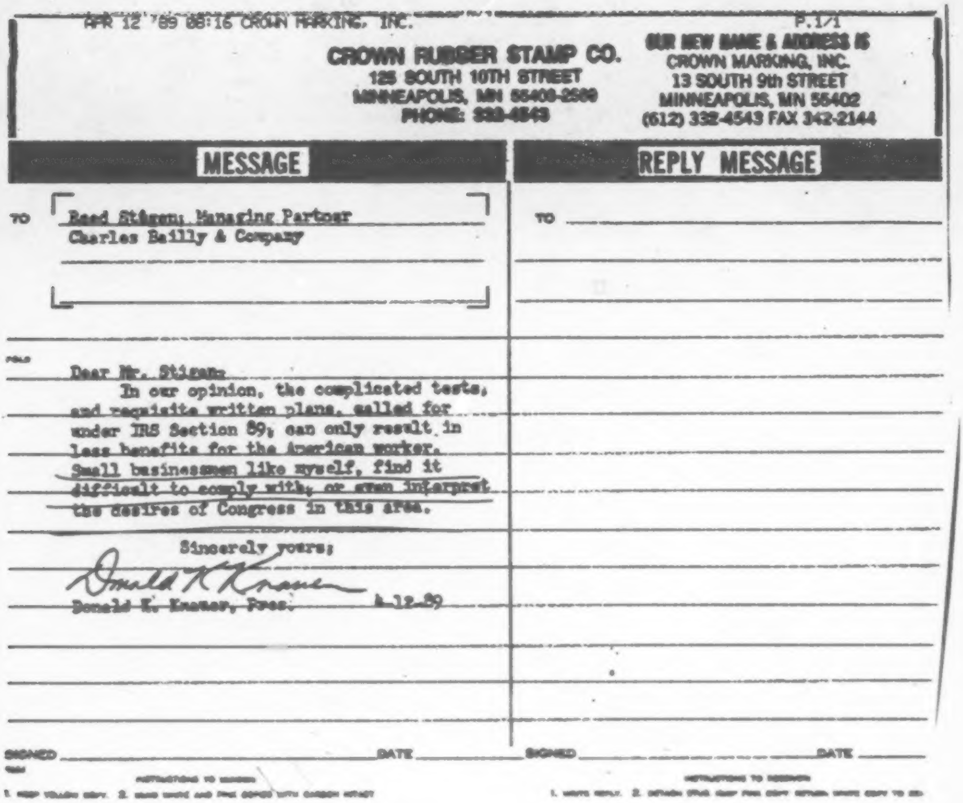
We do not work in the health insurance area so we have no comments with respect to Section 89 in that area.

Good luck in your testimony.

Sincerely,

Larry P. Sullivan, JD

LPS:jt



APR 12 '89 08:16 CROWN MARKING, INC. P.1/1

CROWN RUBBER STAMP CO.
125 SOUTH 10TH STREET
MINNEAPOLIS, MN 55403-2589
PHONE: 332-4543

OUR NEW NAME & ADDRESS IS
CROWN MARKING, INC.
13 SOUTH 9th STREET
MINNEAPOLIS, MN 55402
(612) 332-4543 FAX 342-2144

MESSAGE

TO Reed Stigen, Managing Partner
Charles Bailly & Company

FOLD

Dear Mr. Stigen:

In our opinion, the complicated tests, and requisite written plans, called for under IRS Section 89, can only result in less benefits for the American worker. Small businessmen like myself, find it difficult to comply with, or even interpret the desires of Congress in this area.

Sincerely yours;

Donald K Kramer

Donald K. Kramer, Pres. 4-12-89

SIGNED DATE

REPLY MESSAGE

TO

SIGNED DATE

Apr. 12 '88 9:46 [illegible] CDS TEL 612-235-7871 P. 1

CDS

Conway, Deuth & Schmiesing
Certified Public Accountants

[illegible] E. Conway, CPA
[illegible] A. Deuth, CPA
[illegible] C. Schmiesing, CPA
[illegible], CPA

[illegible] Third Street SW, P.O. Box 570, Willmar, Minnesota [illegible]

MEMBERS
AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS
MINNESOTA SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS

FAX-IT MESSAGE

Date: 4/12/88

Fax #: 1-612-235-7871

Reference #: ________

Total Pages: 2 incl. this page

TO: Name ________________

Firm Charles Bailly & Co.

City Fargo, ND

MESSAGE:

Attached are a few comments from our staff and partners

Thank you,

David Taffe
Firm Administrator

Section 89 Comments

I think we should mention the cost of administration that has to be paid by small business that do not have people on staff.

I have seen a proposal by a consultant firm for $7,000 for the first year and $4,000 - $5,000 after that. Employer with about 200 employees.

Some small business employers are considering cancelling the health plans which they sponsor, just to avoid the cost of administration and threat of penalty.

WANZEK Construction, Inc.
Box 2019 • Exit 64 I-94
FARGO, NORTH DAKOTA 58107
Leo Wanzek, President
Phone 701-282-6171

April 10, 1989

Reed Stigen
Charles Bailly & Co
Fargo,ND 58102

RE: Section 89

Dear Mr. Stigen:

We agree that Section 89 will create many problems, expecially with the construction industry.

We have approximately 150 people on our payroll during the peak construction season and of that 150 only 30 are permanent employees who we provide benefits to. If we were required to provide benefits for people with six months tenure, these people may be qualified for only one months coverage before they would be layed off for the season. Most seasonal people work from one month to seven months. Quite often these seasonal employees are hired only for a particular job and do not wish to travel, also being layed-off when the job is completed. Our question is, who would pay for the benefit and premium during the lay-off period? Also, this person may choose not to come back to our work force. Another added expense.

Our present position is to provide benefits to our regular full time seasonal employees rather than expand the coverage to all employees. Our reason being is Section 89 seems to be very cumbersome and laden with an enormous amount of paperwork.

Again, we reiterate that we do not plan on expanding our program but plan to issue a 1099 for the benefits we do provide to our eligible employees.

Sincerely yours,

Leo Wanzek
LEO WANZEK
President

LW/tap

BRIDGES, SEWER AND WATER, SEWER AND WATER TREATMENT PLANTS, HIGHWAY WORK, SWIMMING POOLS
(We are an Equal Opportunity Employer)

T
C
H

Tioga Community Hospital
and
Nursing Home

BOX 189
TIOGA, NORTH DAKOTA 58852
PHONE (701) 664-3305

LOWELL D. HERFINDAHL
ADMINISTRATOR
RANDALL K. PEDERSON
ASST ADMINISTRATOR

April 10, 1989

Reed Stigen, Managing Partner
CHARLES BAILLY & COMPANY
First Interstate Center, Suite 1100
Fargo, ND 58124

Re: Section 89 of Internal Revenue Code

Dear Mr. Stigen:

I would like to thank you for the opportunity to comment on the concerns I have with the Section 89 rules of the Internal Revenue Code.

As a healthcare provider who depends almost totally on third-party reimbursement, the concern I have with Section 89 are as follows:

With the complexity of the tests for discrimination and the maze that goes with it, I can see the possibility, and I stress possibility, many employers, large and small, eliminating health insurance benefits for their employees and increasing wages in order for employees to go out and purchase their own health insurance coverage. On paper, that sounds alright.

In reality, though, I fear that will not be done by some employees. Instead of purchasing the health insurance coverage with the additional wages paid by the employer, the extra dollars might become part of the normal spending habits of employees and/or their families.

That, in itself, is fine and good, UNTIL, healthcare services are needed by that employee and/or his family. At that time, no health insurance is in effect, therefore, no benefits are available to help defray the cost of the healthcare. The cost must be totally paid for by the employee.

Most people, including myself, do not have the kind of money saved to pay rising healthcare bills of today. With that in mind, our industry could be severaly impacted with cash flow problems, increasing days in accounts receivable, bad debts, interest expense on borrowed money, etc.

This is only one concern of Section 89. I am sure you will receive other viewpoints from other providers of healthcare. Hopefully, you will be able to use this in your testimony on April 13 1989.

Sincerely,

Randall K. Pederson
Assistant Administrator

04/12/89 08:24 002

PACE MANUFACTURING, INC.

April 10, 1989

Charles Bailly & Company
Suite 800 100 North Phillips
Sioux Falls, S D 57102

attn: Mr Reed Stigen, Managing Partner

Dear Mr. Stigen,

We appreciate the opportunity to voice our concerns about the Section 89 laws to you, so you can take them to the U.S. Senate hearing.

We feel these are far too complex for small business's to accommodate and will also disrupt very large business's that will need to test thousands of plans causing them to eventually be less competitive in world markets. Cases will eventually clog our court system in trying to collect a few dollars here and there. Meanwhile billions of dollars in drug money, laundering schemes, S&L fraud, insider stock & commodity activities are going without tax dollars being collected and the honest business man is being strangled with more and more and more gov't regs.

We feel the Section 89 in particular will have the effect of reducing benefits to the workers who need them very badly. For instance it suddenly makes sense to only offer a worker a single health insurance plan rather than a family one. Also it is a temptation to cut off life insurance benefits at $50,000 rather than offer more as a company benefit. On and on, the American worker, and consumer will eventually bear the load of unnecessary costs of compliance. Meanwhile, imports will flourish again, and many American jobs will disappear.

It is time for the poor strangled American to rise up against over regulation and bureaucracy. Thanks for this opportunity and GOOD LUCK!

Sincerely,

Pace Manufacturing Co

Ivan Fisher
General Manager

[illegible] South Sioux Blvd., Box [illegible], Brandon, South Dakota [illegible] Phone ([illegible]) [illegible]-7221

Holiday Inn

April 10, 1989

TO WHOM IT MAY CONCERN:

I believe, in most instances that Section 89 of the Internal Revenue Code will penalize the employees of most companies, especially those businesses that employee a great number of part time workers. The time taken in filing reports and the tremendous increase in cost due to including persons working eighteen (18) or nineteen (19) hours at times and then leaving employment eight (8) or nine (9) months later should be taken into consideration.

I feel many companies will consider dropping Life and Medical coverage for employees which could make a whole new set of problems.

Charles C. Fritz

CHARLES C. FRITZ
Corporate Controller
Holiday Inn of Fargo

HOLIDAY INN®FARGO
3803 13th Ave. South • Fargo, North Dakota 58109 • 701/282-2700
Operated by Wold Properties, Inc. Under License

PRESENTATION CENTER
SACRED HEART CONVENT
1101 32nd Ave. So. Fargo, ND 58103 1-701-237-4857

April 10, 1989

Reed Stigen
Charles Bailly and Company
1100 First Interstate Center
Fargo, ND 58124

Dear Mr. Stigen:

Section 89 of the Internal Revenue Code, in my opinion, offers no new benefit to employees. Its provisions for substantial penalties for non-compliance and convoluted directives have made many employers unduly cautious and decreased the availability of opportunities for part-time employment.

A major problem with compliance with the Section 89 regulations is the time, space, and trees that must be devoted to maintaining records that have no demonstrable usefulness other that being evidence that such records are kept.

Sincerely yours,

(Sister) Mary Margaret Mooney, PBVM

Industrial Builders, Inc.

PHONE [illegible] FAX [illegible]
W.B. DIEDERICH, CHAIRMAN OF THE BOARD
JAMES J. GRESS, PRESIDENT

General Contractors

P.O. BOX 406 FARGO, NORTH DAKOTA 58107

April 11, 1989

Charles Bailly & Company
Reed Stigen, Managing Partner
FAX: 701 237 6427

Dear Reed:

We are general construction contractors working in up to 10 states at any one time.

We employ roughly 30 full time office, clerical, supervisory and shop personnel. All of these people are eligible for health insurance and profit sharing.

We hire craftspersons in order to accomplish the projects which we have under contract. In 1988, we employed 363 such people, who did not receive any health benefits or profit sharing. (Except contributions for roughly 24 people to a benefits fund established in order to comply with Davis-Bacon mandated wages and benefits associated with certain federally funded projects). We have an extremely high turn over of employees in the craft category due to our geographical diversity and the project-specific need for certain craftspersons.

We believe that the costs associated with providing health and profit sharing to all these "temporary" craft people will put us in a non-competitive position which will result in a substantial reduction in our ability to acquire work. We believe that our "permanent" staff are entitled to certain benefits because of their on-going contribution to the vigor of our firm. We need to be able to provide these benefits to our "permanent" staff in order to promote their enthusiasm (profit sharing) and peace of mind (health insurance).

With the implementation of Section 89, we are being forced to consider the elimination of these incentives to our permanent staff in order to maintain our competitiveness.

We feel that there should be some consideration given to the re-structuring of the level at which an employee is deemed to be eligible for these benefits.

Sincerely,

INDUSTRIAL BUILDERS, INC.

Paul Diederich

Paul Diederich
Executive Vice President

We are an Equal Opportunity Employer M/F/V/H

Senator **Boschwitz**. Fine. That is very nice. I am familiar with this gentleman's company, and I am not sure if we have met before, but nevertheless, I am familiar with his accounting firm.

I might say, Mr. Chairman, that we have here also—I hope she will stay—Vallerie Hansen. She is the chief executive officer of a competitor of mine. I do not know how in the world——

Senator **Boren**. I should stay and make sure that the Chairman does not mistreat the witness.

Senator **Boschwitz**. You had better, Senator.

Now we will turn to Terry Neese, the Director of small business of the Oklahoma Chamber of Commerce and Industry.

STATEMENT OF TERRY NEESE, DIRECTOR OF SMALL BUSINESS, OKLAHOMA STATE CHAMBER OF COMMERCE AND INDUSTRY AND SMALL BUSINESS COUNCIL, U.S. CHAMBER OF COMMERCE, ACCOMPANIED BY KAREN BERG, MANAGER, HUMAN RESOURCES POLICY, U.S. CHAMBER OF COMMERCE

Ms. **Neese**. Thank you. Mr. Chairman, Senator Boren, I am very pleased to be here with you this morning. I want you to know that you are hearing from grassroots America, as I reign from Cookietown, OK, population five. And Section 89 does affect, believe it or not, Cookietown, OK.

Senator **Boschwitz**. You are kidding. Cookietown?

Ms. **Neese**. I commend your efforts here this morning and all of the Members that have joined us and gone on to busy schedules, and I know they are very busy, and I commend them for spending the time here and commend you for putting the hearings together.

The Oklahoma State Chamber of Commerce has tried to assist the adverse impact and cost of Section 89 and the IRS regulations on small businesses in the State and has found that less than 2 percent of businesses even know about the law.

Jim Smith, CLU, and president of James L. Smith & Associates, a life insurance planning firm for estates, trusts and corporations, has traveled the State of Oklahoma informing the business community about Section 89 since February 1 of this year. Mr. Smith has made approximately 22 presentations to approximately 500 businesses in the past 2 months. Ninety-eight percent of the business people in attendance were not aware of the new law.

To some extent small businesses rely on the media for information. Unfortunately small business people only have time to read the pictures. There are few pictures that relate to Section 89 that can be put in the newspapers, and I am not sure if C-Span is here today, but if they are not, it is unfortunate that they are not, because it would be really super to have had this to the grassroots people of America.

Employers and employees are just beginning to feel the effects of Section 89, and I have a few examples that I would like to share with you.

Campbell's Clothing in Oklahoma has been in business for 45 years. The business is a partnership with two employees. One employee is a partner, the other is a common-law employee who has been employed for 22 years.

The business has furnished its employees with health insurance and term life insurance benefits for several years. Section 89 compliance would cost this employer $665 for the summary plan document, employee notification form 5500 and compliance testing. The employer decided to drop the employee benefits and give the employees the salary increase of $200, the amount of the cost of benefits to the employer so that they could purchase their own benefits.

Herein lies the problem. After Federal income tax, FICA, and Oklahoma State tax withholding on the $200 salary increase, the employee is left with only $128, probably not enough to purchase health care coverage. Because the employer increased the employees' salaries, the employer's payroll taxes increased approximately 10 percent and the employees' taxes increased as well. Interestingly, because Social Security entitlements are based on total wages earned, Section 89 will increase revenues to the Federal Government now. However, the employees' increased entitlements to Social Security will increase Federal spending. Is the tradeoff worthwhile?

The Chickasaw Indian Nation, a Government agency provides another example of the compliance costs under Section 89. The Chickasaws already pay 100 percent of the cost for health insurance and term life insurance benefits for individuals and families. Even though every individual receives the same coverage, the cost for them to comply with Section 89 is about $2,800. The Chickasaws received another quote from a major health insurance company of approximately $11,000 for the same compliance service.

A hospital in Birmingham, AL, with a 1,400-member staff, will pay about $53,000 to comply at a time when health care costs are spiraling, we should fuel the inflationary fires by imposing unnecessary costs.

In New Mobeetie, TX, a small independent school district with 22 staff members was deciding whether to provide a health benefit at a cost of $25 per month per staff member for a total of $6,600 per year. That may not seem like much, but to a small school system it is plenty. Section 89 compliance costs would add about $700. The school board decided not to provide benefits.

I would certainly be remiss if I did not tell you about my own experience as a small business owner. I own six companies which are still operating. For the past 18 years I have operated a permanent job placement service and a temporary job placement service in the Oklahoma City area. In these two companies I employ nine people on a full-time basis and in the temporary service I employ between 100 and 150 people per week.

Some of these employees work 1 hour per week, some work 2 days per week, some work 2 weeks per month and do not work again for 2 or 3 months. Trying to determine which employees work 17.5 or more hours per week for 6 months would be a recordkeeping nightmare.

I cannot furnish temporary employees who only work 1 day or 1 week the same benefits that I furnish my permanent employees. I made the decision not to provide benefits to anyone in any of my organizations because of Section 89.

In addition, Carrie Abernathy Bell of Postoak Oil in Oklahoma City has dropped her plans. I met a gentleman on the airplane coming up, who is president Michael Elder of Graham Production Co., in Oklahoma City, and he has dropped his plans.

This law is a revenue raiser. It is not a law that is based upon sound health policy and sound benefits policy. The overall impact for the very smallest employers may be complete elimination of group health and term life insurance.

We believe that companies of 50 employees or fewer who do not have counsel on retainer and are harbored in small communities probably are not aware of this new law. I fear that they may be contacted by the IRS a year from now and penalized for non-compliance.

The scenario could end with the employer unable to pay the fine imposed, files for bankruptcy, and lays off as many as 50 employees, thereby affecting the tax base of the community as well. Everybody suffers, but who wins?

Small businesses want to offer health care coverage. Health coverage is the most prevalent fringe benefit offered by employers for firms with more than 10 employees. The provision of health benefits increases with firm size, with the gap narrowing considerably in firms employing 25 or more employees.

We must remember that small businesses create more jobs, train more workers, and remain the backbone of our economy. Employers have no quarrel with the concept of offering benefits to a broad cross-section of employees in exchange for the tax breaks that they receive for providing benefits. But such rules should act as an incentive, not a disincentive to providing coverage. Unless the rules are simple enough so that small businesses can understand, apply, and pass the tests, small businesses will be discouraged from providing and maintaining health benefits.

Almost all small business people have great integrity and treat their employees fairly. Under Section 89 small businesses will suffer, but the employees will suffer more. Congress should repeal Section 89 and allow small businesses the opportunity to meet the needs of their employees as fully and as fairly as they can within their limited resources.

Members seem to see the rose-colored aura of wealth on Wall Street and assume that small businesses have endless resources.

In closing, the stated goal of Section 89 providing health care to the uninsured is one that we share. The U.S. Chamber stands ready to work with the Committee to develop alternatives to expand coverage for the uninsured who are connected to the workforce that do not place excessive burdens on small businesses but trying to coerce businesses to expand benefits coverage by means of complicated tests and stiff penalties simply will not work.

Mandating businesses to provide health care coverage is not the solution either. Big business is what small business wants to be if the Government will not impede the process. If Government does, I fear small business and entrepreneurship may be extinct.

People in Oklahoma are outraged about this, those who are aware of it. If I can leave D.C. today having convinced you and each one of your Members in your Committee to be an advocate for repeal of Section 89, then I know I will be allowed to deplane as I arrive in Oklahoma this afternoon and I am on a short fuse because I have to catch an airplane at about 1:30, so I thank you for being here, and certainly hope your Committee votes totally for repeal.

[The prepared statement of Ms. Neese follows:]

Statement of the U.S. Chamber of Commerce

ON: IMPACT OF SECTION 89 ON SMALL BUSINESS

TO: SENATE COMMITTEE ON SMALL BUSINESS

BY: TERRY NEESE

FOR: OKLAHOMA STATE CHAMBER OF COMMERCE AND INDUSTRY AND THE U.S. CHAMBER OF COMMERCE

DATE: APRIL 13, 1989

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest federation of business companies and associations and is the principal spokesman for the American business community. It represents nearly 180,000 businesses and organizations, such as local/state chambers of commerce and trade/professional associations.

More than 92 percent of the Chamber's members are small business firms with fewer than 100 employees, 59 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—numbers more than 10,000 members. Yet no one group constitutes as much as 32 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 59 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
IMPACT OF SECTION 89 ON SMALL BUSINESS
before the
SENATE COMMITTEE ON SMALL BUSINESS
for the
OKLAHOMA STATE CHAMBER OF COMMERCE AND INDUSTRY
and the
U.S. CHAMBER OF COMMERCE
by
Terry Neese
April 13, 1989

Mr. Chairman and members of the Committee, my name is Terry Neese. I am Director of Small Business for the Oklahoma State Chamber of Commerce and Industry and serve on the Council of Small Business of the U.S. Chamber of Commerce. Additionally, I am an entrepreneur and founder of six companies which are still operating. I am accompanied by Karen Berg, manager of human resources policy for the U.S. Chamber. Today I am testifying on behalf of the Oklahoma State Chamber of Commerce and the U.S. Chamber.

Section 89 has sparked more confusion and outrage in the small business community than any other issue in recent memory. This law requires employers to collect, maintain and update vast quantities of information. This information is used to determine whether or not benefit plans discriminate against lower-paid workers and, if so, the additional income that must be imputed to highly-paid employees who receive "discriminatory" employer-provided benefits. The stated goal of Section 89 is to encourage employers to expand benefits coverage to include more lower-paid and part-time workers. But the law is so complicated that it seems as if it were designed to frustrate employers into taxing benefits.

The Oklahoma State Chamber of Commerce has tried to assess the adverse impact and costs of Section 89 and the Internal Revenue Service (IRS) regulations on small businesses in the state and has found that less than two percent of businesses even know about the law. Jim Smith, CLU and President of James L. Smith and Associates, Inc., a life insurance planning firm for estates, trusts and corporations, has travelled the state of Oklahoma informing the business community about Section 89 since February 1 of this year. Mr. Smith has made approximately 22 presentations to approximately 500 businesses in the past two months. Ninety-eight percent of the business people in attendance were not aware of the new law.

Employers and employees are just beginning to feel the effects of Section 89. Let me give you a few examples of the problems that this law has caused:

o Campbell's Clothing in Duncan, Oklahoma has been in business for 45 years. The business is a partnership with two employees. One employee is a partner, the other is a common law employee who has been employed for 22 years. The business has furnished its employees with health insurance and term life insurance benefits for several years. Section 89 compliance would cost this employer $665 for the summary plan document, employee notification, form 5500 and compliance testing. The employer decided to drop the employee benefits and give the employees the salary increase of $200 (the amount of the cost of benefits to the employer) so that they could purchase their own benefits.

Herein lies the problem: After federal income tax, FICA and Oklahoma State tax withholding on the $200 salary increase, the employee is left with only $128 -- probably not enough to purchase health care coverage. Because the employer increased the employees' salaries, the employer's payroll taxes increased approximately 10 percent and the employees' taxes increased as well. Interestingly, because Social Security entitlements are based on total wages earned, Section 89 will increase revenues to the federal government now; however, later the employees' increased entitlements to Social Security will increase federal spending. Is the trade-off worthwhile?

o The Chickasaw Indian Nation, a government agency, provides another example of the compliance costs under Section 89. The Chickasaws already pay 100 percent of the costs for health insurance and term life insurance benefits for individuals and families. Even though every individual receives the same coverage, the cost for them to comply with Section 89 is about $2,800. The Chickasaws received another quote from a major health insurance company of approximately $11,000 for the same compliance service.

o A hospital in Birmingham, Alabama with a 1,400-member staff will pay about $53,000 to comply. At a time when health care costs are spiralling, we should not fuel the inflationary fires by imposing unnecessary costs.

o In New Mobeetie, Texas a small independent school district with 22 staff members was deciding whether to provide a health benefit at a cost of $25 per month per staff member (for a total of $6,600 per year). That may not seem like much; but to a small school system, it is plenty. Section 89 compliance costs would add about $700. The School Board decided not to provide benefits.

o I certainly would be remiss if I did not tell you about my own experience as a small business owner. For the past 18 years, I have operated a permanent job placement service and a temporary job placement service in the Oklahoma City area. In these two companies, I employ nine people on a full-time basis; and in the temporary service, I employ between 100 and 150 people per week. Some of these employees work one hour per week, some work two days per week, some work two weeks per month and do not work again for two or three months. Trying to determine which employees work 17.5 or more hours per week for six months would be a recordkeeping nightmare. I cannot furnish temporary employees who only work one day or one week the same benefits that I furnish my permanent employees. I made the decision not to provide benefits to anyone in any of my organizations because of Section 89.

Attached are two articles that further describe the problems that businesses face in trying to comply with Section 89. The first outlines the particular problems that temporary help agencies are encountering. The second, from Nation's Business magazine, provides an excellent overview of the issue and the compliance problems that Section 89 has caused for businesses of all sizes.

This law is a revenue raiser. It is not a law that is based upon sound health policy and sound benefits policy. The overall impact for the very smallest employers may be complete elimination of group health and term life insurance. We believe that companies of 50 employees or fewer who do not have counsel on retainer and are harbored in small communities probably are not aware of this new law. I fear that they may be contacted by the IRS a year from now and penalized for noncompliance. The scenario could end with the employer, unable to pay the fine imposed, filing for bankruptcy and laying off as many as 50 employees, thereby affecting the tax base of the community as well.. Everybody suffers, but who wins?.

The ostensible purpose of Section 89 is to encourage employers to expand their benefit plans to include more lower-paid and part-time workers. The consideration and enactment of this provision occurred at the same time that efforts have been made to increase health care coverage for the employed, as well as the unemployed. Small business has been the focus of the debate over expanding health care coverage because most of the working uninsured are found in small firms. Ironically, Section 89 will impede, rather than encourage these efforts. Many smaller companies, as they discover the complexities of compliance, will decide not to offer benefits at all.

Small businesses want to offer health care coverage. Health coverage is the most prevalent fringe benefit offered by employers for firms with more than 10 employees. The provision of health benefits increases with firm size, with the gap narrowing considerably in firms employing 25 or more employees.

Small business employers with health plans are more likely than large firms to include part-time, temporary or seasonal workers in health coverage plans. Small firms hire more of these types of workers and may make them eligible to broaden their risk pool or to attract and retain these employees. The U.S. Chamber recently released its latest employee benefit survey, which found that companies in which part-time workers comprised more than 10 percent of the work force were more likely to award the same benefits to part-time and full-time workers.

We must remember that small businesses create more jobs, train more workers and remain the backbone of our economy. Employers have no quarrel with the concept of offering benefits to a broad cross section of employees in exchange for the tax breaks that they receive for providing benefits. But such rules should act as an incentive, not a disincentive, to providing coverage. Unless the rules are simple enough so that small businesses can understand, apply and pass the tests, small businesses will be discouraged from providing and maintaining benefit plans.

Almost all small business people have great integrity and treat their employees fairly. Under Section 89, small business owners will suffer, but employees will suffer more. Congress should repeal Section 89 and allow small businesses to opportunity to meet the needs of their employees as fully and as fairly as they can within their limited resources. Members seem to see the rose-colored aura of wealth on Wall Street and assume that small businesses have endless resources.

The Council of Small Business of the U.S. Chamber, which consists of small business owners from across the U. S., met in March in Washington, D.C. and voted unanimously to support repeal of Section 89. The Small Business Council of the Oklahoma State Chamber of Commerce and Industry, comprised of small business owners from across the state of Oklahoma, met one week later and also voted unanimously to support repeal. The overwhelming consensus of both groups is that this law is fundamentally flawed and should be repealed.

Section 89 assumes that an employer is discriminating in the provision of benefits unless the employers establishes evidence to the contrary. Why must we prove our innocence? If the object of this law is to raise revenues, then do not disguise the goal as concern for lower-paid employees.

As far as Oklahoma's small business community is concerned repeal of Section 89 is the only answer.

In closing, the stated goal of Section 89 -- providing health care to the uninsured -- is one that we share. The U.S. Chamber stands ready to work with the Committee to develop alternatives to expand coverage for the uninsured who are connected to the work force that do not place excessive burdens on small businesses. But trying to coerce businesses to expand benefits coverage by means of complicated tests and stiff penalties simply will not work. Mandating businesses to provide health care coverage is not the solution either.

Big business is what small business wants to be, if the government will not impede the process; if government does, I fear small business and entrepreneurship may become extinct.

Attachments

National Association of Temporary Services

ATTACHMENT 1

Legal Line

By Ann M. Overbeck
Fisher & Phillips

Section 89–The Good News And The Bad News

In the world of benefits, the "talk of the town" is Section 89 of the Internal Revenue Code (the "Code"). Section 89 imposes "qualification" requirements on numerous kinds of employer-sponsored welfare benefit plans. It also imposes "nondiscrimination" requirements on some of the same kinds of plans.

Section 89 was enacted as part of the Tax Reform Act of 1986 ("TRA '86") and is effective for plan years beginning in 1989. However, as late as November 1988, Congress was still changing Section 89, and the Internal Revenue Service has yet to issue Section 89 regulations. To add to the uncertainty, the Chairman of the Small Business Committee of the U.S. House of Representatives introduced in January legislation to repeal Section 89.

Unfortunately, the uncertainty does not eliminate an employer's need to comply with Section 89. This article will discuss compliance with Section 89 in three respects. First, it will discuss the general rules for compliance with Section 89. Second, this article will discuss special considerations under Section 89 for a temporary help agency with respect to the plans it maintains for its employees. Third, the article will discuss special considerations under Section 89 for the clients of a temporary help agency with respect to the temporary employees they use.

General Rules Of Section 89

Qualification Requirements

As compared to the nondiscrimination requirements of Section 89, the qualification requirements are less talked about but potentially just as troublesome. The tax sanction for an employer's failure to comply with the qualification requirements is servere—all employees who received benefits under the plan during the year must include those benefits in income for federal tax purposes. For example, consider an employee who received surgical benefits of $10,000 under this employer's health plan in 1989. If the employer's plan did not meet the qualification requirements for 1989, the employee would have to include $10,000 in his gross income on his 1989 Form 1040. In addition, if the employer did not report the $10,000 on the employee's 1989 Form W-2, the employer would be subject to a penalty tax of $2,800.

The qualification requirements consist of five rules: (1) The plan must be in writing; (2) Employees' rights under the plan must be legally enforceable; (3) Employees must be provided reasonable notification of benefits available under the plan; (4) The plan must be established with the intention of being maintained for an indefinite period of time; and (5) The plan must be maintained for the exclusive benefit of employees. These rules apply to a broad range of welfare benefit "plans," from traditional benefit plans like health plans and group-term life insurance plans to "fringe benefits" like employee discounts.

Nondiscrimination Requirements

Section 89's nondiscrimination requirements are intended to prevent discrimination in favor of "highly compensated employees." The Code gives a very specific definition of "highly compensated employee." Very generally, a highly compensated employee is an employee who owns more than 5 percent of the employer's business, makes more than $81,720, makes more than $54,480 and is in the top-paid 20 percent of employees, or is an officer and makes more than $49,032.

The nondiscrimination requirements apply to accident or health plans (generally excluding disability plans providing income replacement benefits) and group-term life insurance plans. (The employer can elect to apply the nondiscrimination requirements to certain other plans, but this option is not discussed in this article). Under the nondiscrimination requirements, an employer's plans must meet one of two groups of tests designed to measure eligibility for coverage and the value of coverage provided. However, Section

(continued on Page 12)

New Members Approved.

The following firms were approved as new members at the February 10, 1989 Board of Directors meeting in Ft. Lauderdale, FL. Please welcome these new TempNet members:

Rosemarie LaManna
ADVANCE PERSONNEL TEMPORARY SERVICES, INC.
Reading, PA

Rebecca & Richard Guest
PERSONNEL RESOURCES
Dothan, AL

In addition, the following is a new Associate member:

Jon Haber
USEABLE PORTABLE PUBLICATIONS, INC.
Winchester, MA

It is with regret we report the following firms are no longer members of TempNet:

PERSONNEL CONCEPTS, INC.
Columbus, GA

QUALITY TEMPORARY SERVICE
Houston, TX

SUSAN MONEY TEMPORARIES
San Antonio, TX

MARK YOUR CALENDAR

89
March 31-April 1
REGION III MEETING
Chicago, IL

June 14
BOARD OF DIRECTORS MEETING
Washington, DC

June 14-17
12th ANNUAL CONVENTION
Washington, DC

September 15-16
REGION IV MEETING
Baltimore, MD

LEGAL LINE

(continued from Page 4)

89 allows an employer to exclude certain categories of employees in nondiscrimination testing. In determining who can be excluded, the employer must consider all plans of the same type, and the employer cannot exclude employees in a given category if any employee in the category is covered under any plan of the same type. Subject to those rules, some of the categories of excludable employees are: (1) Employees who have not met the plan's waiting period, but only to the extent the waiting period is not longer than six months for "core" health benefits under an accident or health plan or one year otherwise; (2) Employees who normally work fewer than 17-1/2 hours per week; (3) Employees who normally work six or fewer months during the year; and (4) Employees who do not meet the plan's minimum age requirement (if any), but only if it is not over age 21.

Section 89 also allows an employer to exclude certain categories of employees in nondiscrimination testing, if employees in those categories are covered under a separate plan that meets the nondiscrimination requirements.

Plans Of A Temporary Help Agency

The nondiscrimination requirements of Section 89 may cause special problems for a temporary help agency. It appears to be usual in the industry for a temporary help agency to provide benefits like health insurance to office staff but not to temporary employees. However, as an employer, a temporary help agency is subject to Section 89 with respect to the welfare benefit plans it maintains for its "employees." Thus, the nondiscrimination requirements of Section 89 could cause problems for a temporary help agency that has highly compensated employees on its office staff if its temporary employees are "employees" for purposes of Section 89.

Currently, there is no general definition of the term "employee" for purposes of Section 89. As used in ERISA and the Code's qualified plan rules, the term "employee" generally means an individual who has the status of an employee under the "common-law" rules. Also, the Code's employment tax rules (FICA, FUTA, and income tax withholding) define the term "employee" as an individual who is a common-law employee. Thus, it is likely that an "employee" for purposes of Section 89 is a common-law employee.

Regulations and other IRS publications concerning the Code's employment tax rules generally provide that an individual is a common-law employee of the recipient of his or her services, if the recipient has the right to control and direct the individual as to the details of the work and its results. IRS has considered relationships like the usual temporary help agency/client relationship and has determined that the temporary employees supplied to the client are in fact common-law employees of the agency. Therefore, the agency was held responsible for meeting the Code's employment tax rules with respect to the temporary employees.

The issue of whether a temporary help agency's temporary employees are its common-law employees (and not independent contractors) may be crucial under Section 89, if the agency provides benefits to highly compensated employees on staff but not to the employees it provides to clients. It appears to be usual in the industry for a temporary help agency to pay temporary employees and comply with the Code's employment tax rules by treating temporary employees as employees. To the extent that this practice is based on the legal conclusion that tem-

(continued on Page 13)

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LEGAL LINE

(continued from Page 12)

porary employees are the agency's common-law employees, the agency should consider the temporary employees to be employees for the purposes of Section 89. If, in an individual situation, an agency's temporary employees should not be considered its common-law employees, but the agency treats them as common-law employees under the Code's employment tax rules as a matter of administrative convenience, the temporary help agency may want to reconsider its position in light of Section 89.

Assuming a temporary help agency's temporary employees are its common-law employees, passing the nondiscrimination tests may be unlikely if benefits are provided to highly compensated employees on staff but not the temporary employees. Furthermore, the categories of excludable employees for purposes of nondiscrimination testing probably will not be broad enough to solve the problem.

One solution would be for the temporary help agency to provide benefits to highly compensated employees on a taxable basis. Another solution would be to provide benefits to temporary employees, possibly by taking advantage of the "excludable employees plan" exception to nondiscrimination testing.

Plans Of Clients Of A Temporary Help Agency

The nondiscrimination requirements of Section 89 may also cause special problems for the clients of a temporary help agency. Not only does Section 89 apply to a client's own employees, it also applies to any temporary employees who must be considered the client's "leased employees."

First of all, if in an individual situation temporary employees are in fact the client's common-law employees, the client may have the same problem with the nondiscrimination requirements that is described above for the temporary help agency. In other words, if in that situation the client maintains plans for its own staff, including, highly compensated employees, but not for temporary employees it uses, it may not be able to pass the nondiscrimination tests.

The second potential problem Section 89 poses for clients of a temporary help agency involves the leased employee rules. Temporary help agencies and their clients have been wrestling with the leased employee rules since they were enacted by the Tax Equity and Fiscal Responsibility Act ("TEFRA"). Under TEFRA, a client's use of temporary employees who met the definition of "leased employee" could affect the client's qualified pension or profit sharing plans. TRA '86 extended the leased employee rules so that now a client's use of temporary employees who meet the definition of "leased employee" can affect the client's compliance with Section 89.

Generally, after TRA '86, a "leased employee" is an individual who is not an employee of the client but who provides services to the client if the following rules are met: (1) The services are performed under an agreement between the client and a "leasing organization;" (2) The individual has performed services for the client on a substantially full-time basis for at least six months in the case of "core" health benefits or one year otherwise; and (3) The services performed are of a type historically performed in the client's business field by employees.

Once a temporary employee becomes the client's leased employee, the client must consider the employee to be its own employee for purposes of Section 89 and count him or her in nondiscrimination testing even if the client provides no benefits to the individual. However, under the leased employee rules, the client can treat any benefits provided to the leased employee by the leasing organization with respect to services performed for the client as benefits provided directly by the client.

Whether or not counting leased employees in nondiscrimination testing will cause a problem for the client depends in large part upon the facts and circumstances of the case. Certainly, the client would need to know, on a regular basis, what benefits (if any) the agency was providing to its temporary employees that the client could treat as benefits it provided.

Conclusion

The qualification requirements of Section 89 are important and should not be overlooked by either a temporary help agency or its clients. The nondiscrimination requirements may be a problem for a temporary help agency that only provides benefits to its office staff, including, highly compensated employees, and for a client of a temporary help agency if temporary employees are actually its own common-law employees or must be considered leased employees.

Obviously, the potential problems of the temporary help agency and the client under Section 89's nondiscrimination requirements overlap. One or the other of the entities will have to be concerned with the affects of not providing benefits to temporary employees. In addition, any benefits provided by the agency might be helpful to the client in nondiscrimination testing with respect to any leased employees.

Fisher & Phillips recommends that a temporary help agency work with its clients in coordinating solutions to any Section 89 problems. Provision of some level of benefits to temporary employees may be a solution that helps both the agency and its clients. Your agency may want to consider a Section 89 seminar or another approach to provide clients assistance in addressing the confusion Section 89 has generated. *

Letter To The Editor

Dear TempNet:

Two years ago my firm was facing a dilemma often expressed by independently owned services when time and resources are limited. The dilemma--how to stay a leader in a fast-paced, ever changing industry facing new challenges daily.

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Through TempNet, QUIZ became affordable and offered our solution to computerized testing and training.

Jon Haber's "Useable Portable Guide" helped to open and secure word processing orders and won the devotion of our temporaries by demonstrating our support to their success.

Thanks, Dub Anderson, for making it possible for our marketing materials to get the attention of even the most stubborn decision makers.

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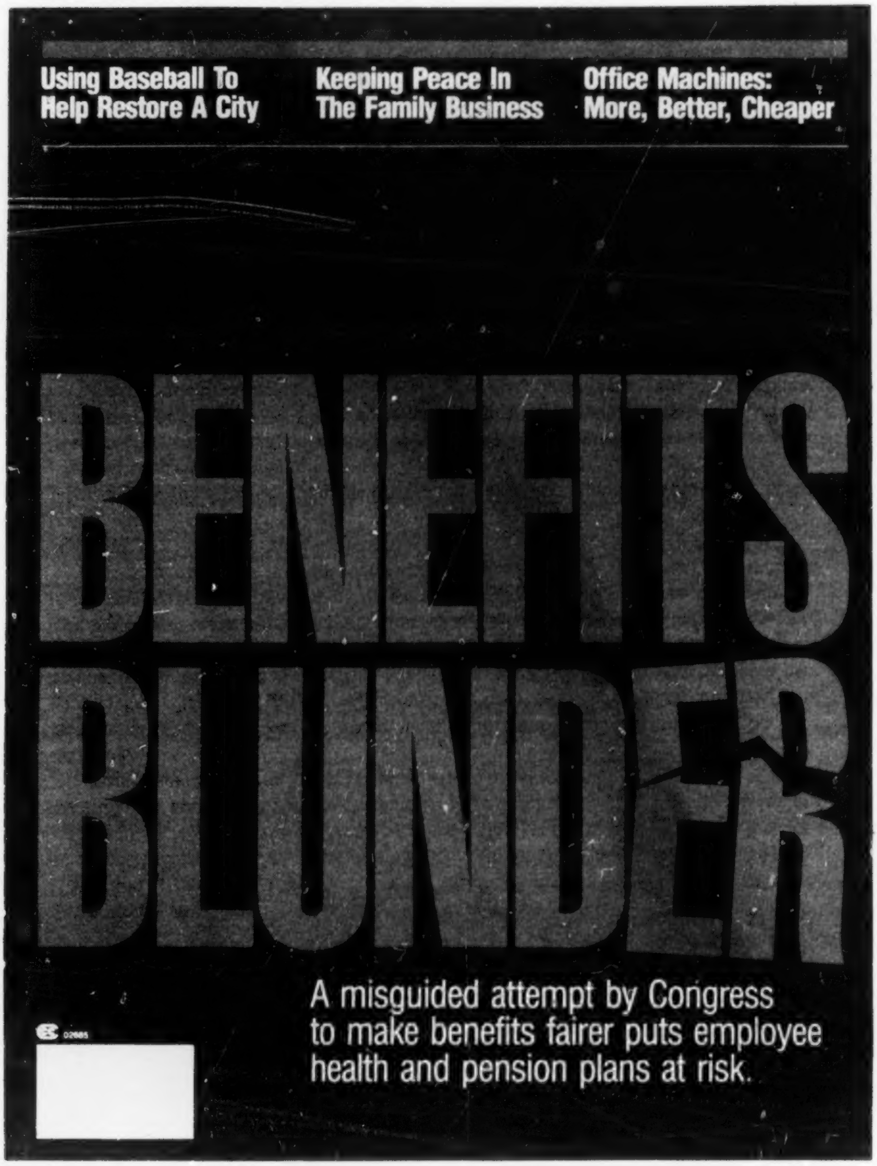
And most importantly are the TempNet friends who are always willing to lend support to help assure each other's success.

Thank you TempNet.

Sincerely,
Judy Simpson, President
TEMPS, Inc., Lexington, KY



Using Baseball To Help Restore A City

Keeping Peace In The Family Business

Office Machines: More, Better, Cheaper

BENEFITS BLUNDER

A misguided attempt by Congress to make benefits fairer puts employee health and pension plans at risk.

Nation's Business February 1989

"Government Gone Crazy"

By Roger Thompson

ILLUSTRATION: DALE GLASGOW

It was the end of another long day for Steven Ferruggia, whose mastery of a new, perversely complex federal benefits law has generated more consulting business than he can comfortably handle. His students—42 business owners, benefits managers, lawyers, and consultants—had paid $195 apiece for an all-day workshop at Boston's Logan Airport Hilton. Participants had flown in from across New England and from as far away as Houston.

Ferruggia and two colleagues from New York-based Buck Consultants performed feats of verbal alchemy, laying out in clear English what Congress had cloaked in turgid prose. But no amount of explaining would relieve the sense of quiet desperation that pervaded the room. Puzzled looks and furrowed brows revealed by expression what went unspoken: This time, Congress had gone too far.

"I think this law will cause a lot of small employers to dump their benefit plans," Ferruggia said in a private moment after the workshop. "It's big government gone crazy," said Edward Maguire, a consultant with Sapers & Wallack in Cambridge, Mass.

The law in question is Section 89 of the federal tax code, one of several provisions that affect employee benefits and were added by the 1986 Tax Reform Act but were not effective until Jan. 1, 1989. Section 89 sets stiff tax penalties for employer-paid health insurance, life insurance, and other nonpension employee benefit plans that favor higher-paid workers.

Businesses that discriminate in favor of higher-paid workers have two choices: broaden and/or extend coverage to lower-paid workers or report the "discriminatory" portion of the higher-paid workers' benefits as taxable income.

Also effective Jan. 1 was another tax-law change that, while it has not drawn as much criticism as Section 89, could

A misguided attempt by Congress to make benefits fairer for lower-paid workers puts employee plans at risk because many smaller companies—as they discover the complexities of compliance—may be discouraged from offering benefits at all.

prove no less burdensome to some employers. The change requires employer-provided retirement plans—including pension, profit-sharing, and so-called 401(k) savings plans—to meet rigid tests for fairness to workers who are not in the "highly paid" category defined in the law. Failure to comply with minimum coverage and participation requirements could result in loss of tax-favored status for both the plan sponsor and the plan participants. (See box on Page 24.)

Taken together, the new requirements imposed by Section 89 and the new pension-plan rules represent Congress' deepest penetration yet into the employer-provided benefits system. Experts say the two provisions encompass more changes and affect more plans than even the sweeping 1974 Employee Retirement Income Security Act (ERISA). That law placing intricate controls on employer-provided pension plans marked Congress' first concentrated attempt to regulate private-sector employee benefits. Since then, the lawmakers have amended and expanded employee-benefits laws almost annually, often to the confusion and dismay of employers.

In enacting Section 89, Congress said its goal was the extension of benefits, especially health insurance, to millions of lower-income workers who are inadequately covered or not covered at all. Under the law, part-time employees who work as *few* as 17.5 hours a week must be included in calculations to determine whether plans are discriminatory.

The congressional Joint Committee on Taxation explained its intent this way: "The [Section 89] non-discrimination rules should require employers to cover non-highly compensated employees to an extent comparable to the coverage of highly compensated employees."

But those who are familiar with Section 89 contend that it will have the opposite effect. "It will tend to decrease flexibility and increase administrative costs," says Frederick J. Krebs, manager of business and government policy for the U.S. Chamber of Commerce. "The effect will be fewer benefits and fewer businesses offering benefits."

Lobbyists mill around outside the congressional conference committee during its marathon sessions on the Tax Reform Act of 1986.

***If** King George and Parliament had come up with anything like Section 89, it wouldn't have taken seven years to win the Revolutionary War.*

THOMAS VEAL
TOUCHE ROSS AND CO.

"When you look at the cost of compliance, it's just not worth it," says Garry Jerome, a consultant with Mercer Meidinger Hansen Inc., in Philadelphia.

Many major industrial companies expect to spend more than $1 million on compliance costs. An employer with 500 workers can expect to pay upwards of $25,000 for a consultant. A firm with 200 workers could pay $10,000 or more. Small companies may have trouble finding advice for less than $1,000.

The high price of compliance is driven by the law's complexity. Section 89 is an administrative nightmare because it takes what appears to be a simple health plan—like those offered by many small companies—and multiplies it into several plans for testing purposes. Take a medical plan that offers coverage for single workers, workers with children, and workers with spouses, with each option offering two different deductibles. Under Section 89, that plan becomes six plans, and each

It's big government gone crazy.

EDWARD MAGUIRE
SAPERS & WALLACK

must meet the non-discrimination tests. Some major corporations with multiple plants and various benefit packages will have hundreds of plans to test.

Because the chances of failure to comply increase with the number of options available to employees, many employers will feel pressure to cut back on choices now available and steer clear of providing new ones.

The enormous complexity of Section 89 has prompted its critics to speculate that Congress was more interested in raising revenue than expanding benefits. "It's really a revenue statute dressed up to look like a do-gooder statute," says Howard C. Weizmann, executive director for the Association of Private Pension and Welfare Plans.

The joint tax committee estimates that Section 89 will net about $300 million a year in revenue derived largely from treating a portion of higher-paid employees' benefits as taxable income. But Congress may have greatly underestimated the law's impact for two reasons.

First, lawmakers may have been too optimistic about the law's ability to persuade employers to extend benefits to lower-paid employees. Kent A. Mason, the law's chief architect, told a health-care seminar in December that in most cases, employers will count any discriminatory excess benefits as income to highly paid workers and will "gross up" those employees' salaries—that is, increase their salaries to cover the newly taxable portion of benefits. "This option is much cheaper than extending benefits to low-paid workers," said Mason, who was counsel to the joint tax committee and now works for the Washington law firm of Caplin & Drysdale.

Second, widespread non-compliance would produce huge amounts in unanticipated tax penalties, warns Mary Hevener, a benefits attorney with the Washington law firm of Lee, Toomey & Kent. Employers who fail to comply with the non-discrimination rules will pay a tax penalty, calculated at the highest individual tax rate, on the benefits received by the highly compensated.

In addition, employees will be taxed on any benefits they receive if the employer fails to maintain a so-called qualified plan, which entails compliance with another set of rules similar to those already applied to pension plans.

Ferruggia and other consultants should be delighted about Section 89. Washington insiders regard it as a consultants' full-employment act. But consultants find themselves in the uncomfortable position of serving as shock troops for advancing a law that almost nobody can believe Congress actually passed.

Pat Haines, senior consultant in the Philadelphia office of the Coopers & Lybrand accounting and consulting firm, says the general reaction she gets from business audiences is, "I can't believe this is happening."

"I think if we are going to cause another American Revolution, Section 89 is it," says Thomas Veal, senior tax manager with Touche Ross and Co. in Washington. "If King George and Parliament had come up with anything like Section 89, it wouldn't have taken seven years to win the Revolutionary War."

In fact, Section 89 slipped through the tax-reform process with little notice. "No one focused on benefits changes" in the 1986 tax-reform legislation, said a Senate aide. "They just sort of happened."

How To Comply With Section 89

Section 89 of the Internal Revenue Code denies tax-favored treatment of employer-provided benefit plans that discriminate in favor of employees who are highly paid. The law became effective Jan. 1 and applies to all employers, public and private. Only churches are exempt.

The law has two distinct parts: qualification rules similar to those for pension plans, and non-discrimination rules. The qualification rules are less difficult to handle but more onerous in their penalties. These rules apply to all tax-favored employee benefits.

There are five tests for maintenance of a "qualified" plan. It must be in writing, employees' rights must be legally enforceable, employees must be notified of the plan's benefits, the plan must be exclusively for employees, and the plan must be maintained indefinitely. Employers have until Dec. 31, 1989, to put the necessary documents in order, but they must operate the plan in accordance with its provisions from the beginning of the year.

Failure to meet any of the qualification requirements carries severe penalties in the form of extra taxes for employer *and* employees. All employees will be taxed on the payouts they receive from an employer-provided plan. For example, if the company's health plan pays out $50,000 on behalf of an employee with a catastrophic illness, that money becomes taxable income to the employee.

In addition, employers who fail to report benefit payouts on employees' W-2 forms must pay an excise tax on the total payouts, calculated at the highest individual tax rate.

The non-discrimination rules form the heart of Section 89 and apply only to employer-provided health-care, accident, and group life-insurance plans. These rules pose the toughest compliance problems.

Before testing for discrimination, an employer first must assemble a considerable amount of data, including the number of the company's highly compensated employees, the number of employees excluded from testing, and the number of benefits plans subject to testing.

For the typical small business, highly

Section 89 At A Glance

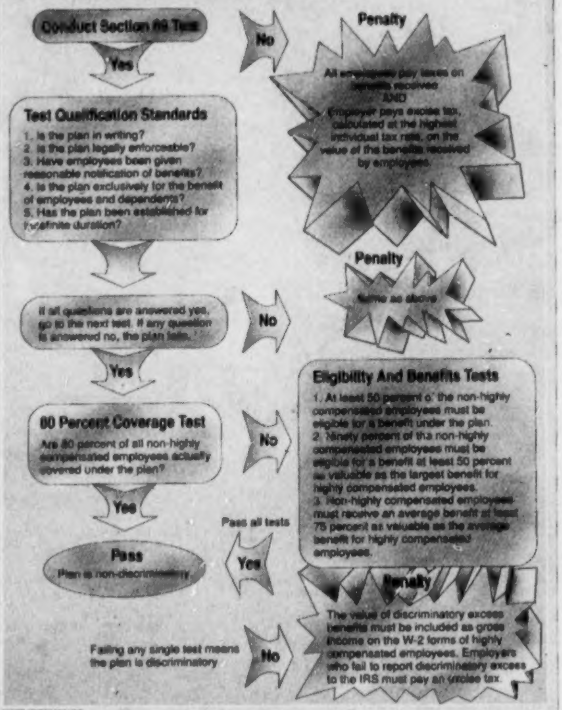

Conduct Section 89 Test
Yes
No
Penalty
All employees pay taxes on benefits received
AND
Employer pays excise tax, calculated at the highest individual tax rate, on the value of the benefits received by employees.
Test Qualification Standards
1. Is the plan in writing?
2. Is the plan legally enforceable?
3. Have employees been given reasonable notification of benefits?
4. Is the plan exclusively for the benefit of employees and dependents?
5. Has the plan been established for indefinite duration?
If all questions are answered yes, go to the next test. If any question is answered no, the plan fails.
No
Penalty
Same as above
Yes
80 Percent Coverage Test
Are 80 percent of all non-highly compensated employees actually covered under the plan?
No
Eligibility And Benefits Tests
1. At least 50 percent of the non-highly compensated employees must be eligible for a benefit under the plan.
2. Ninety percent of the non-highly compensated employees must be eligible for a benefit at least 50 percent as valuable as the largest benefit for highly compensated employees.
3. Non-highly compensated employees must receive an average benefit at least 75 percent as valuable as the average benefit for highly compensated employees.
Yes
Pass all tests
Yes
Pass
Plan is non-discriminatory
Failing any single test means the plan is discriminatory
No
Penalty
The value of discriminatory excess benefits must be included as gross income on the W-2 forms of highly compensated employees. Employers who fail to report discriminatory excess to the IRS must pay an excise tax.

CHART: [illegible]

compensated employees are those who are 5 percent owners or who earned at least $52,235 in 1988. The dollar amount will rise yearly to reflect inflation.

Excluded from testing are employees under age 21, anyone who works less than six months a year, anyone who has not completed a year of service (or six months of service for core health benefits), anyone who works less than 17.5 hours a week, and employees subject to collective-bargaining agreements.

Some small businesses—those with nine or fewer employees—may take three years to phase in coverage of part-time employees, defined as those who work at least 17.5 hours a week.

If an employer provides benefits to even one person in an excluded group, the exclusion is denied, and everyone in that group must be included in testing.

For testing purposes, a benefit plan may be viewed as more than one plan. Each variation in coverage, employer or employee contribution, copayment, or deductible creates a benefit plan that must be tested separately. For example, a medical plan that offers single-person and family coverage and two levels of deductibles is actually four different plans for testing.

Employers have two ways to prove that their plans do not discriminate:

- **80 Percent Coverage Test.** This is the less complex of the two methods. A plan passes this test if 80 percent of the employees who are not highly compensated actually receive coverage.
- **Eligibility And Benefits Tests.** As an alternative, an employer may show that the company's plan passes each of the three following tests:

90 Percent-50 Percent Eligibility Test. Ninety percent of the non-highly compensated employees must be eligible for benefits at least 50 percent as valuable as benefits for highly compensated employees.

50 Percent Eligibility Test. At least 50 percent of non-highly compensated employees must be eligible for a benefit under the plan, or the percentage of eligible highly compensated employees is no higher than the percentage of eligible non-highly compensated employees.

75 Percent Benefits Test. Non-highly compensated employees must actually receive an average benefit at least 75 percent as valuable as the average benefit for highly compensated employees.

Cafeteria plans, which allow employees to choose among several options for health and other benefits, are subdivided and tested like any other plan. Each option is a separate plan for testing purposes. Benefits provided through salary-reduction plans also are treated as separate plans for testing.

There is no penalty imposed on the employer for maintaining a discriminatory plan. But the employer must determine the amount of discriminatory excess received by the highly compensated employee and report it to the employee and to the IRS as taxable income. If an employer fails to report the discriminatory excess to the IRS, the penalty is an excise tax, calculated at the highest individual tax rate, on total benefits received by the highly compensated employees.

Employers pass or fail the non-discrimination tests based on the benefits available on any one day in the 1989 plan year. For 1989, employers may choose the last day of the year to perform the tests.

Do You Have Questions?

If you want to ask us questions about Section 89, we'll answer them in future issues of the magazine. Write to us at *Nation's Business*, Section 89 Question, 1615 H Street, N.W., Washington, D.C. 20062.

Now, many employers are dragging their feet on compliance, waiting for it to collapse under its own weight. "We are hearing from employers who are predicting that Congress will repeal Section 89 sometime in [1989] after the outcry [over its complexity] begins," says Ken Feltman, executive director of the Employee Council on Flexible Compensation. He estimates that 60 percent of all businesses, primarily small companies, have not yet heard about Section 89, making ignorance of the law a major obstacle to compliance.

While large and midsized firms typically are staffed to keep abreast of changes in benefits laws, many small firms don't have the facilities to do so.

Observes Donald Utter, owner of Medical Personnel Pool, in Madison, Wis.: "It's the one secret that the government has been able to keep. Almost every small-business person I mention it to doesn't know what I'm talking about."

But small-business owners shouldn't assume that Congress will come to the rescue. Section 89 has powerful friends on Capitol Hill, including the two key

[illegible] Plans

[illegible]

percent of all [illegible]—whichever number is lower.

- **Coverage.** A plan must satisfy at least one of the three following minimum tests: (1) It covers at least 70 percent of all employees who are not highly compensated. (2) The number of covered employees who are not highly compensated equals at least 70 percent of the number of highly compensated employees who are covered. (3) At least 70 percent of all employees must benefit, and the average benefit for employees who are not highly compensated must be at least 70 percent of that for highly compensated employees. All of a company's tax-qualified retirement plans, including profit-sharing and 401(k) plans, must be included when determining each participant's average benefit.
- **Integration.** Employers previously could treat their retirement plans and Social Security as a single, integrated plan in determining whether overall retirement income unduly favored highly paid employees. [illegible] benefit formulas [illegible] sharply [illegible] integrated plans, [illegible] many firms [illegible] benefits [illegible] reduce [illegible] calendar [illegible] in [illegible]

[illegible] with Social Security. Some experts speculate that the rest of the regulations, affecting the most controversial aspects of the new law, may not be ready for months.

Congress last year refused requests from business to delay the law's effective date. It did, however, recognize the difficulty of interpreting the new rules by absolving from penalty those plan sponsors who, in the absence of regulations, make "good-faith" efforts to follow the law's intent. "We did not get the delay that we wanted, and some people may still be in violation of the rules when the actual regulations come out," says David L. Wray, president of the Profit Sharing Council of America, which promotes profit sharing as a practice. "But at least people are off the hook for now."

However, experts say that plan administrators by now should have examined their companies' programs to determine, as best they can, whether the plans pass Congress' new fairness tests.

"I tell clients to take the worst-case scenario, just so there won't be any surprises when the regulations are issued," says Roy K. Sinclair, senior vice president of Booke & Co., an employee-benefits consulting firm in Winston-Salem, N.C.

Veal of [illegible] sees a silver lining in the new rules for some employers. "The biggest problem," he says, "is going to be in sitting down and thinking out what the company's retirement objectives are and what it is trying to do in its pension, profit-sharing, 401(k), or whatever. That's probably a useful exercise. Some companies may discover that they'll be better off, because they've been going along for years with plans that didn't make any sense for them, that they'd just been putting money into them without determining [illegible]

[illegible]

I think this law will cause a lot of small employers to dump their benefit plans.

STEVEN FERRUGGIA
BUCK CONSULTANTS

figures behind the 1986 Tax Reform Act—Rep. Dan Rostenkowski, D-Ill., chairman of the House Ways and Means Committee, and Sen. Bob Packwood, R-Ore., ranking minority member of the Senate Finance Committee.

The law reflects a longstanding concern among many lawmakers that the federal government doesn't have enough control over who gets tax-exempt, employer-paid benefits, according to staffers on the tax-writing committees. The joint tax committee estimates that employer-provided health-care plans alone cost the government $32 billion a year in "lost" revenue.

That kind of money, Congress decided, should produce better social-policy results, namely health insurance for lower-paid workers. Section 89 was driven by the perception that many employers were giving their highest-paid employees generous benefits while giving their lower-paid employees less or nothing at all. Supporters of this view note that 52 percent of the 37 million Americans who have no health insur-

The Ever-Tightening Federal Grip On Employee Benefits

Congress' grip on private companies' employee benefits has grown increasingly firm since 1974, as shown in the following legislative chronology.

1974. Employee Retirement Income Security Act (ERISA). Established minimum participation, vesting, funding, and termination standards for employer-sponsored pension plans. Mandated prefunding of pension benefits. Prohibited pension plans, or sponsoring employers, from reducing benefits to recipients. Created the federal Pension Benefit Guaranty Corp. (PBGC), funded by employers, and set an annual premium of 50 cents per participant—paid by employers—to insure private-sector pension plans.

1980. ERISA Amendments. Tightened funding requirements and limited federal liability for multiemployer pension plans covering some 8 million workers in the construction and other industries. Established standards governing the merger or transfer of multiemployer plans. Allowed employers' annual premiums to the PBGC to rise to $2.60 per pension-plan participant.

1982. Tax Equity and Fiscal Responsibility Act (TEFRA). Set limits on benefits in "top-heavy" pension plans in which key employees accrue more than 60 percent of benefits. Imposed special rules to assure minimum coverage, faster vesting, and other benefits for pension-plan participants who are not key employees. Revised requirements governing integration of pension-plan benefits with Social Security. Amended the rules for computing the share of employer-paid group life-insurance premiums to be included in an employee's adjusted gross income.

1984. Retirement Equity Act. Made 21 the age at which employees must be allowed to enroll in pension plans; the minimum age for many plans had been 25. Required employers to begin counting at age 18, instead of 22, an employee's years of service for pension vesting. Permitted employees to leave a job for five years—longer in some cases—and return without losing pension credit. Barred pension plans from counting a one-year maternity or paternity leave as a break in service.

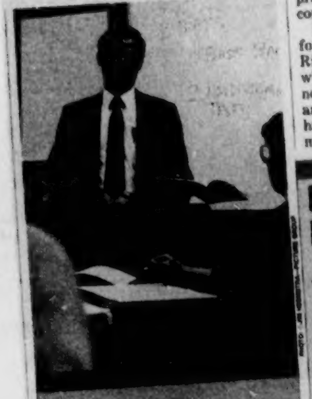
1984. Deficit Reduction Act. Sharply curtailed the tax advantages of voluntary employee trust funds, the primary mechanisms available to employers for prefunding retiree health benefits.

1985. Consolidated Omnibus Budget Reconciliation Act (COBRA). Required employers with more than 20 employees to make available health-care coverage for up to 18 months to employees who leave the company for any reason other than gross misconduct. Also extended coverage to widows, divorced spouses, and some dependents for up to 36 months. Raised the employer's annual premium to the PBGC to $8.50 per worker.

1986. Tax Reform Act. Established comprehensive non-discrimination rules for coverage and participation in employee plans for health, life insurance, and other welfare benefits. Made sweeping changes in rules affecting coverage, participation, and vesting of tax-favored private pension plans. Tightened rules governing 401(k) programs. Restricted tax-deductible contributions to 401(k) plans and Individual Retirement Accounts (IRAs).

1987. Omnibus Budget Reconciliation Act (OBRA). Stiffened ERISA requirements for advance funding of employer-sponsored pension plans. Required employers to begin prefunding tax-qualified pension plans quarterly, instead of annually, starting in 1989. Boosted employer premiums to the PBGC to $16 per worker.

1988. Technical and Miscellaneous Revenue Act. Included, among hundreds of technical corrections and clarifications to existing tax law, multiple substantive changes affecting the rules applying to virtually all statutorily recognized employee benefits. Eased slightly some of the most controversial non-discrimination rules, enacted in 1986, covering employee welfare and pension benefits.



To expect small business to understand Section 89 is . . . ludicrous.

Ron Danilson
Principal Financial Group

ance either work full time or are members of families headed by full-time workers. Accordingly, Congress cracked its tax-policy whip, forcing employers to fall into line or risk losing a tax subsidy for highly paid workers. Said one congressional staff member who worked on the legislation: "Why should the government be satisfied that blue-collar workers are getting less than white-collar workers?"

Business owners generally have no quarrel with Congress' intent. It's the execution that has benefits managers throwing up their hands in frustration.

Most large and midsized companies have turned to outside consultants for assistance. Small firms may find they have no other choice, says Feltman, of the Employee Council on Flexible Compensation. "In the end, what we have is a technician's dream and a layman's nightmare," he adds, explaining that Congress made Section 89 "so complex that the traditional expert that the small-business owner has relied on, his insurance broker, is no longer an expert. Now he'll have to go to higher-priced talent: lawyers, accountants, and consultants."

Reed Creaser, secretary/treasurer for General Crane and Hoist Inc., in Richmond Hill, Ga., already knows what it's like to ask questions and get no answers. "I've asked several insurance companies to send me what they have on Section 89, but nobody has sent me anything yet. The individual agents seem to be as much in the dark as we are," he says.

Whether individual employers discriminate or not, the law puts the burden of proof on them. Collecting and analyzing the data needed on each employee frequently may cost more than correcting any discrimination that is found. In fact, an employer may sink thousands of dollars into data collection

Employers' Payroll Costs For Employee Benefits

The yearly cost of private-sector employee benefits climbed in 1987 to an average $10,708 per full-time worker, compared with $10,283 the year before, according to *Employee Benefits 1988*, a new U.S. Chamber of Commerce survey of large, midsized, and small businesses. Average employee benefits as a percent of payroll dipped slightly to 39 percent in 1987 from 39.3 percent in 1986, the survey found. The decline, the Chamber said, indicated that benefits are rising but at a slower pace than pay.

"The study of employee benefits issues is more than just a matter of idle curiosity," said Richard W. Rahn, vice president and chief economist of the Chamber.

"In the past year a number of bills have been introduced in Congress that would mandate employers to provide health-care, parental-leave, and other benefits at federally mandated levels. With the information provided in this survey, employers can determine the impact of such legislation by analyzing the cost of providing benefits to their employees and by understanding the full cost of an individual employee."

Health insurance was the most widely provided voluntary benefit reported. Ninety-nine percent of the companies indicated at least some payment toward employee health care. The only benefits as widely available to employees were the legally mandated ones—Social Security, unemployment compensation, and workers' compensation.

Hospital, dental, and other medical coverage cost employers an average $2,189 per worker in 1987, virtually unchanged from $2,184 the year before. Stringent cost-containment programs, begun in 1987, helped keep down such expenditures despite a 6.6 percent jump in medical costs generally, a Chamber spokesman said.

Benefits varied significantly among industries, with costs in dollar value and as a percent of payroll generally higher among manufacturing firms than among service-sector firms. The Chamber noted, however, that service firms are increasing their benefits at a faster clip than manufacturing firms.

Sharp regional variations in benefit costs also appeared. Companies in the East North Central area, home of many older companies with huge liabilities for retirees' pensions and health-care benefits, paid more than 44 percent of payroll on employee benefits in 1987. In other regions, outlays ranged from 36.2 percent of payroll in the Northeast to 39.2 percent in the Southeast.

Payment for vacations, holidays, and other leave appeared to be the fastest-growing employee benefit, averaging 11 percent of total payroll cost in 1987, up from 10.2 percent in 1986. The survey turned up a trend in the paid-leave field: Some firms have begun offering employees a fixed number of leave days each year to use as they like for vacations, holidays, and sick leave.

As in previous years, larger companies reported higher expenditures for employee benefits than did smaller companies. The highest amount—39.5 percent of payroll—was paid last year by companies with 5,000 or more employees. Firms with 10 to 49 employees paid the lowest, 31.9 percent of payroll.

Employee Benefits 1988 is the 26th such survey by the Chamber. Originally biannual, it has been conducted yearly since 1979. For a copy, send $20 to Employee Benefits, U.S. Chamber of Commerce, 1615 H Street, N.W., Washington, D.C. 20062, or call (301) 468-5128.

—Donald C. Bacon

and analysis just to show that no discrimination exists.

Among the law's data requirements are those that compel employers to:

- Identify the highly compensated and the non-highly compensated.
- Determine who may be excluded from the tests.
- Identify each benefit that must be tested.
- Sort out the family status of employees for separate family coverage testing.
- Determine the number of former employees subject to testing.
- Determine whether parts of an organization can be tested as a separate line of business.

Once the information is assembled, it isn't enough to show that coverage was offered. Benefit plans will be judged by the percentage of employees who actually participate.

The Section 89 Coalition, a group of 190 associations and businesses, lobbied unsuccessfully last year for a one-year delay in Section 89. The coalition's efforts were motivated in part by the Treasury Department's failure to produce regulations to implement the law. But Congress was in no mood to start chipping away at tax reform, especially when delay would add $300 million to the federal budget deficit.

"The coalition met very heavy resistance from Rostenkowski," said Christine Hartoft, a legislative assistant with the Association of Private Pension and Welfare Plans. "He wasn't interested in anything that would make it look like tax reform was unraveling."

Nonetheless, the Technical and Miscellaneous Revenue Act of 1988, signed into law Nov. 11, did contain some of the coalition's recommendations for simplifying the law. Among them:

- Employers may test their benefit plans for compliance with non-discrimination rules on one day of the year; they do not have to track each benefit choice by each employee for each day of the year.
- Benefit plans will not fail the non-discrimination tests simply because too many employees choose to be covered by their spouses' plans.
- Companies with nine or fewer workers may phase in coverage for part-time employees, those who work at least 17.5 hours a week, over three years.

The latter two changes are major concessions to the concerns of small companies, says Ron Danilson, assistant director of group operations with the Principal Financial Group of Des Moines, Iowa. A 1988 company survey of 100 employers with fewer than 10 workers found that up to 70 percent would fail, primarily because of the initial participation requirements for part-timers and workers covered by a spouse's insurance plan.

But even with the changes, the law and the monumental problems it poses for employers remain basically intact. "To expect small business to understand Section 89 is absolutely ludicrous," says Danilson. Others who have studied the revisions still don't like what they see.

"It seems to me that if a company is considering putting in a health-care plan, and they run into this, they will just forget it," says Frank L. Mason, president of the Mason Corp., a Birmingham, Ala., manufacturer of metal building products.

"It's just too much of a burden to keep up with all the detail and still run a business," he adds. "You can just load a small-business wagon so full, and when you get beyond that, something has to give." ■

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Senator Boschwitz. We thank you for being here.

I turn to Senator Boren.

Senator Boren. I apologize. I am going to have to go over to an Intelligence Committee meeting. Let me say I hope you will be able to deplane, because I hope to be able to deplane there tomorrow myself, and I hope that we will have some statement from Treasury before that time. But I appreciate your testimony very, very much.

I apologize to the other witnesses. I am going to have to leave you to the tender mercies of Senator Boschwitz here because I do have to go to another meeting, and I am delayed. But this kind of testimony that we have been hearing is very, very helpful to us.

I think the focus—here we have these concrete examples of exactly how this impacts. I think about the example of the store in Duncan, OK, which we just heard. It really brings it home that the people that—people who are going to end up suffering most from this are employees because these plans are going to be dropped. Employers are going to say well, I will just pay you now what I was giving you in benefits in order to avoid the possibilities of these penalties and the cost of recordkeeping and compliance and all the rest of it.

And, as you pointed out, the employee ends up much worse off. Plus, you are going to have some employees that are going to say gee, I just cannot afford to do it at all. You are going to have more people who are going to end up without coverage. They are going to have medical emergencies. They are going to be in real trouble. It hurts them, and then you have got hospitals that do not have their bills paid. You have all sorts of problems on down the line.

So, from the point of view of policy, it is totally unsound. It will have just the opposite result from what was anticipated and what happens on down the line with Social Security, and so on. Ultimately, I am convinced it is going to be a net cost to the Government and not a net gain.

These kinds of examples we have been hearing are very, very helpful testimony. I look forward to reading the testimony of our other witnesses.

I thank all of you for taking the time and effort to be a part of this today. It has been very helpful to us as we make the case. It will be helpful to me as I go to the Finance Committee also to make the case as a Member of that Committee to try to get repeal.

Senator Boschwitz. You know, the Government has not been enriched by $72 in the example of your clothing store. They may be taking the short-term view jingling that money in their pocket and saying we are the winners of this, perhaps intentional or unintentional. But we have to tell them in the long view they certainly are not going to be the winners.

Senator Boren. In the long run they are not the winners because you have to think about how many people have been qualifying for higher Social Security benefits, how many businesses, how much health care expenditures are going to go up, and again, serving on the Finance Committee, one of the greatest problems we have right now are uncollectible medical bills because people do not have coverage.

So, when you look at the outflow in so many other ways, I think if they do any sensible counting, they will find that this really ends up hurting.

Senator BOSCHWITZ. Thanks, Ms. Neese. I would say in the event that you have to just pick up and leave or you, Mr. Stigen, that you should just do so. You need not wait until the end of the panel.

But I would echo the thoughts of the distinguished Senator from Oklahoma that your testimony is very helpful, and I hope that you will collect those letters and also you, Ms. Neese, in the hope that the U.S. Chamber, whom you are representing, has more such letters. They would be helpful as well.

And, Ms. Houle, you, too, if you bring some letters from some of the cities and towns in Minnesota, it would be helpful.

Thank you very much for remaining so long, Senator Boren.

Now, we turn to Ms. Hansen.

As you may or may not know, she runs a very nice company, the Big Buck Building Centers. Prices are a little high, and that is why people come over to our place.

I had not been to your place for some years. I used to live in Oshkosh and used to drive down to Chicago, and I would stop and see what the competition was doing.

And even when I operated stores in Milwaukee, I used to come down.

Ms. HANSEN. I see your sons on TV now.

Senator BOSCHWITZ. And we consider you to be a formidable and good competition.

STATEMENT OF VALERIE HANSEN, CHIEF EXECUTIVE OFFICER, BIG BUCK BUILDING CENTERS, RACINE, WI, ON BEHALF OF THE NATIONAL LUMBER & BUILDING MATERIAL DEALERS ASSOCIATION AND THE SMALL BUSINESS LEGISLATIVE COUNCIL, ACCOMPANIED BY JOHN SATAGAJ, LEGAL COUNSEL AND PRESIDENT, SMALL BUSINESS LEGISLATIVE COUNCIL

Ms. HANSEN. Thank you. I am not going to reread my testimony which I believe you all have unless there is a sentiment to do so.

Senator BOSCHWITZ. We will put your prepared statement, in its entirety, in the record.

Ms. HANSEN. Senator Boschwitz, I do want to thank you for inviting myself on behalf of the National Lumber and Building Material Dealers and the Small Business Legislative Council to be here today. We have already introduced the nature of my business. It is lumber and to some degree wholesale and manufacturing as well.

We are a small company. We have heard a lot about small businesses. I am a small employer. We have 88 employees, 80 of which are full-time employees. We are roughly half retail and half manufacturing. About one half of those employees are union members.

My overwhelming reaction sitting in the room this morning was one of absolute pleasure and relief to hear how you did not need to be convinced that this was bad legislation and that it was unworkable, that indeed, we are far beyond that.

And I was delighted to hear Senator Boren and yourself insisting to Mr. Trier that we get on today. Yesterday would have been soon enough in informing businesses that they indeed do not have to comply to this

I assure you that we are spending time doing pretest. We are looking—we are trying to figure out how to position ourselves to however the law may be. In my case we have already expended roughly $3,000, and I will be honest. The motivation was a union contract. That union contract is up July 1. It is a multi-employer contract. It has historically been a 3-year contract, so it will go until July 1992, and we have been in the position before where retroactively we have been asked to comply to something that was on the books from 1986 and why should we not have complied in July 1989. That kind of a problem makes it very timely for us.

In addition to the $3,000 we have already expended, the cost that we are projecting and when you are in union negotiations it is an open checkbook, believe me, is roughly $7,500 in our budget line for what this might cost.

I will point out to you that that correlates in terms of a deduction, a legitimate business expense, a deduction of my taxable profits of $2,550 for this year, so that the Treasury will receive that much less in taxes from me.

Senator **Boschwitz**. But as you heard, the Treasury——

Ms. **Hansen**. What I read yesterday in the Wall Street Journal coming out $1–$5 billion and my math was real easy on the low end, $1 billion times 34 percent is $340 million.

I have been told the revenue estimates were as high as $300 million. Guys, you have already lost $40 million, and if you do not implement it, you have been losing money all year because some of us have been trying to comply and spending money right now.

Senator **Boschwitz**. But as the Treasury pointed out, your expense is somebody's income.

Ms. **Hansen**. In this case it was a lot of it because we had collected on paper—we are sophisticated in our lumber projections and our inventory control. We have an outside payroll service, we have some inside activities. We do not have computers that talk to computers doing all of these things. So, we went through 2 years of W-2 information.

It has been a rapid growth year. We collected all that data from my 1988 immediate, and we, too, are a seasonal state, so right now I have 1988. It will be a 100 in season. For those 88 employees I had 195 data documents to look at which had to be hand collected. Some of those people could have worked for us for 3 hours and said this is too hard and left, but they had to be documented as being an employee.

That kind of effort cost over 2 weeks of payroll clerk time. I am taking expenses that are essentially going out of meeting my customers' needs, out of meeting our purchasing needs, out of meeting the management requirements of our company so far. A lot of the rest of it will go to attorneys.

When you get into the union negotiations, that is a reality. That negotiation process is going on now. The contract is July 1. One of the clear problems with this law is there is no multi-employer language as it relates to trustees in union contracts. I cannot control that contract. I sign an agreement that says so much per hour.

They can modify the provisions of that contract. It is clearly under the language, not my plan.

Right now my reading of the plan is that it is discriminatory. I am trying to participate in good faith negotiations, and I want to know if that plan is discriminatory, where is the remedy? Does the teamster business agent get fined? Do I? Do my highest ranked teamster employees or does everybody? I do not know, and apparently from Mr. Trier's testimony the Treasury does not know and will not know until this fall. But my negotiations are right now.

When we come to the entire question of multiple earners, I have not heard any testimony related to signing off. That has been a big thing in my immediate area. A number of employers have offered incentives to their employees to voluntarily remove themselves from their plans because they are not part of the counting process.

That has led to what I think may well be a fiasco if we go forward with this about who signs off first and for what incentive.

As it relates to small business, it creates some special problems for us. My non-union group plan has fewer than 50 people in it. As we seek to look at this, I have asked my insurance representative if I have people waiving off of my plan because they are covered under a wonderful plan under S.E. Johnson or some other major employer with very generous benefits right now, fine. But what if there is a change in that person's life situation? Divorce, separation, relocation, whatever? How can my employee get back on my plan? There is not an option right now.

They are going to have to, in effect, either wait a year if, indeed, the plan will take them at all related to no pre-existing conditions, renegotiate it. I do not take those things quietly. And he suggested that if we had a plan of 100 or more actuarially, they could afford to leave that in an open enrollment situation, and I would suggest to you if that is the insurance industry's answer that we keep hearing it is actuarially if it is 100 or more, then small business is going to have a terrible problem because we do know our employees one by one. And it is very hard to look at somebody and say I am really delighted you are already completely covered somewhere else.

But please know there are no guarantees that you can ever be covered here if you sign off today. That is a scary position to be in and annual open enrollment or something would be helpful.

Essentially I salute you. The 10,000 lumber dealers represented in the National Lumber and Building Material Dealers last month unanimously voted for the repeal of Section 89.

They are, for the most part, fairly aware of it because we tend to be seasonal employers. They are very aware of the part-time provisions and find that very onerous.

Thank you, Senator Boschwitz.

[The prepared statement of Ms. Hansen follows:]

Testimony of

Valerie Hansen
Big Buck Building Centers
Racine, Wisconsin

on behalf of

The National Lumber & Building Material Dealers Association

and

Small Business Legislative Council

before the

Senate Small Business Committee

Hearings on

Section 89 of the Internal Revenue Code

April 13, 1989

I extend my thanks to Senators Boren and Boschwitz, and the other members of the Committee, for the opportunity to testify on Section 89 of the Internal Revenue Code. I am Valerie Hansen, Chief Executive Officer, of Big Buck Building Centers of Racine, Wisconsin. I am testifying today on behalf of the National Lumber & Building Material Dealers Association (NLBMDA) and the Small Business Legislative Council (SBLC). Accompanying me is John Satagaj, Legal Counsel and President of SBLC. In addition to my written statement, I ask that NLBMDA be associated with the opinions expressed in SBLC's submittal.

NLBMDA is a federated trade association comprised of 10,000 independent, family-owned and -operated retailers of lumber and building materials. The average NLBMDA member has annual gross sales of $3 - $4 million, employs 22 - 25 workers, and provides an array of employee benefits. SBLC is a permanent, independent coalition of one hundred trade and professional associations that share a common commitment to the future of small business. The membership represents the interests of more than four million small businesses in manufacturing, retailing, distribution, professional and technical services, construction, transportation and agriculture.

I consider myself a small business person, a lumber dealer from Racine, Wisconsin. My company is 50 percent retail, with two traditional full-service lumber yards, and 50 percent wood-products manufacturing, with a truss plant and architectural millwork company. In 1988 my company's gross sales were $11 million. We currently employ 88 people; 80 are full-time. Although my company is larger than the average NLBMDA member, the way we are structured and the nature of the benefits we provide our employees is representative of our industry.

We are an established company, having been founded sixty years ago by my grandfather. That means we have survived the Great Depression, World War II, material shortages, wage and price controls, inflation, and sky-high interest rates. One year in the early 1980's, my home town of Racine issued only one residential building permit. We are resilient folks in a highly competitive industry.

As a small business, our goal is to serve our customers' needs in a timely fashion and at a fair price. As a lumber dealer, I need to focus on my customers and the efficient purchasing and delivery of goods. I also must focus on employee growth, team building, improving productivity, and leading the company through its seventh decade.

Increasingly, my time is taken by federal and state regulations and reporting requirements. To borrow a phrase from the educational establishment, "it's time off task" -- time off the task of meeting my customers' needs. For all successful businesses, meeting the customers' needs is the bottom line. Which brings me to Section 89 of the Internal Revenue Code and the focus of today's hearing.

My accountant tells me Section 89 is basically a tax law. If the intent of Section 89 is to raise monies, please have the candor to raise my taxes directly. Raising my tax means I must focus on how to pay from the legitimate profits of my business. A direct tax means my energy is spent on the task of running my business instead of collecting reams of data, diligently working to understand the laws, and ascertaining whether my benefit plans meet the Section 89 discrimination and qualification provisions.

Needless to say, this activity is costly. I know you have heard and will continue to hear about the cost of collecting, documenting, and testing the data. I would argue this cost is disproportionately greater for small employers due to economies of scale.

But in addition to my expense, I would suggest that Section 89 will have an adverse effect on federal revenue. The cost of testing for compliance is a legitimate business expense. This sort of non-productive overhead directly affects my bottom line, my profits. As such, it reduces federally taxable income and monies to the U.S. Treasury.

My company has already invested $3,000 in preliminary data collection and in simply trying to understand the regulations. With union negotiations at stake -- and no clear multi-employer regulations -- I have no cap to the potential costs. But for discussion, let's assume everything is reasonable and that I can finish the actual test and comply for $7,500 or roughly $94 per person. At the current corporate tax rate of 34 percent, this will cost the federal government $2,550 in tax revenue. Again, setting aside the issue of my union employees, I anticipate no liability to my company from Section 89.

For the apparent purpose of raising revenue, you have increased expenses, decreased profits, and reduced my taxable income. A rather adverse effect when multiplied by businesses across the country on the federal Treasury.

A second purpose of Section 89 is an attempt to address the complex issue of providing health care and who shall pay for it. The high and accelerating cost of providing health care is a crisis for both the private and public sectors. The costs on the private sector have been increasing rapidly, in part, due to cost-shifting from the public sector. My current annual cost for providing employee health coverage is $189,000. And health care is just one of many employee benefits my company provides.

How significant can the cost of providing health insurance be on my total business? The numbers, based on patterns that already exist, are illustrative. My analysis is based on information from the top half of the lumber and building material industry -- in other words, good, solid companies.

Over the past several years, the average employer cost of providing health care benefits in my industry has averaged 1.8 percent of gross sales. My health care costs have averaged 2.0 percent of gross sales and are increasing. Let's assume a 5 percent increase in gross sales volume per year and -- because these are good lumber dealers -- we'll also assume they experience a 5 percent increase in gross profits per year. How long will it take until the very viability of the business is threatened if the cost of health care benefits increases 20 percent per year, while all other expenses (such as salaries, insurance, etc.) are held to 5 percent increases?

The answer is seven years. In seven years the top firms in my industry will face operating losses instead of profits, with health care coverage as the only item out of balance to other basically inflationary increases. It can certainly be argued that 20 percent is a conservative number. Many small businesses have experienced premium increases in the 50+ percent range and limitations on the coverage of the insurance they can afford. This extrapolation is based on continuing to cover the employee group as it is presently defined, without the additional mandates of Section 89.

Small businesses cannot long operate with deficits. I suggest the question of health care and who will pay deserves to be considered as a matter of broad social policy; not as a technical amendment to the Internal Revenue Code. The inherent complexity of Section 89 and its regulations are a disincentive to providing or adding employee benefits, and a strong incentive for dropping existing ones.

My company has completed what I will refer to as a Section 89 "pre-test" to develop basic data on my employees. In doing so, we looked at all W-2 employees for two years. One hundred-ninety-five employees were examined and forms were completed for each. And, I would not characterize our company as having high turnover. Indeed, some of the individuals worked for us only a matter of hours, but even this had to be documented.

As I stated earlier, of my employees, about one-half are union members, being fairly evenly divided between the Teamsters and Carpenters Unions. My preliminary analysis is that neither union contract as presently structured will meet the Section 89 requirements. Both involve health plans controlled by an independent group of Trustees. My current Teamsters' contract expires July 1, 1989. The contract is traditionally for three years and involves multiple employers covering two counties in southeastern Wisconsin. It is clearly not my plan as defined in Section 89.

If the Teamsters' contract is not brought into compliance with Section 89 in the next three months -- and assuming the IRS defines what compliance will be by July 1 -- is it acceptable to tax my "highly compensated employees" on their premiums as a remedy for the Teamsters' benefit plan's discrimination? I do not have an answer, but clearly the viability of that contract will be in question.

Among my employees, and the workforce in general, multi-wage earner households are in the majority. Current law and regulations allow employers to exempt from their tests employees who waive the coverage and document that they are covered under another plan. Very small businesses have responded very quickly and are already eliminating plans or encouraging employees to sign off. In some cases, employers large and small -- including public sector employers -- are paying a special bonus to their employees who waive coverage. The practice of who signs off first, and for what incentive, may be a fiasco.

Further, and more specific to small business, I asked my insurance carrier what their position will be if one of my employees who has waived coverage has a change in his/her life situation and at some time desires group coverage. I was told the person would not necessarily be accepted onto the plan, and that if he/she were accepted, pre-existing conditions would not be covered for one year. After much discussion, it was suggested that if I had one hundred or more employees under the plan, this provision might be waived!

This certainly adds a discriminatory burden to small employers. It would be very difficult to advise employees with alternate coverage to leave the plan with no defined option of returning. This dilemma is most acute for small employers.

Finally, Section 89 mandates a broad array of benefits to employees working 17-1/2 hours per week. To my knowledge, most benefit plans define "part-time workers" as persons working less than 30 or 32 hours per week. I assume the intent was to pick up a segment of under-employed or otherwise working persons without health insurance benefits and put them under private sector coverage. Although the goal may seem a reasonable one, the results are likely to be contrary to the intent.

For the financial reasons noted earlier, all coverage will be levelled or eliminated. Ironically, "highly compensated employees" will, in response to poorer plans, select to discriminate and enjoy more complete coverage. Those who can afford to pay will have the discriminatory plans this law sought to eliminate.

In closing, lumber and building material dealers and other small business persons are vitally concerned about affordable, quality health care for themselves and their employees. For the most part, small business owners know their employees on a personal level. And, ultimately, we know that our employee's best interest is directly served by maintaining a viable business. Mandates, like Section 89, diminish small businesses' ability to be profitable and do little to meet the individual needs of employees.

Repealing Section 89 would be a positive step in helping small business provide the goods and services the public demands and to meet the needs of our employees.

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Last month, lumber and building material dealers representing every state in the nation unanimously passed a resolution urging this Congress to repeal Section 89. That resolution is attached at the end of my testimony.

NATIONAL LUMBER AND BUILDING MATERIAL DEALERS ASSOCIATION NLBMDA

SECTION 89

RESOLUTION

Whereas, the goal of Section 89 -- increased equity in the providing of employer-sponsored benefits -- is not attainable as the law is currently written, because the statute cannot be reasonably complied with or enforced, and;

Whereas, the extreme complexity of the Section 89 benefits tests, costly administrative requirements, and the compliance burden imposed by the law, in combination with escalating health care costs and COBRA regulations, will have an adverse impact on the continuance and expansion of health care coverage for workers, and;

Whereas, the Internal Revenue Service's proposed regulations complicate, rather than clarify, Section 89, and;

Whereas, compliance with Section 89 places a real burden on small businesses which try to provide employee benefits in a fair and equitable manner;

Be It Resolved,

that delegates to the National Lumber & Building Material Dealers Association Conference with Congress urge the Congress to repeal Section 89 and examine simplified alternatives to current law.

Adopted March 20, 1989

40 IVY STREET, SE • WASHINGTON, DC 20003 • (202) 547-2230
Facsimile 1-202-547-7640

Small
Business
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STATEMENT OF

Small Business Legislative Council

Before

The Committee on Small Business

United States Senate

April 13, 1989

1025 Vermont Avenue, NW/Suite 1201/Washington, D.C. 20005/(202) 639-8500

We appreciate the opportunity to testify today and look forward to working with this committee once again during the 101st Congress. We only wish that we could begin the new Congress on a more positive note. The subject today is Internal Revenue Code Section 89. As you know, Section 89 is the child of the Tax Reform Act of 1986 (TRA), a law which we viewed with considerable doubt at the time of passage. The emergence of Section 89 as a problem for small business only serves to reinforce our belief that, lower rates notwithstanding, TRA was, and is, the source of substantial heartburn for most small business owners.

The Small Business Legislative Council (SBLC) is a permanent, independent coalition of nearly one hundred trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of over four million small businesses in manufacturing, retailing, distribution, professional and technical services, construction, transportation and agriculture. A list of our members is attached.

The first, and most logical question to ask, is why are we here today if Section 89 was enacted over two years ago? The answer is that the debate over tax reform was an important one for small business, and quite frankly most of us in the small business community devoted what resources we had to other issues related to tax reform. Second, in our many years of work for, and with, small businesses, we have come to learn that you deal with those things today which affect the bottom line today. Fighting tomorrow's battles frequently take a back seat. While this is not an excuse, it is a reality within which we must work.

Third, and most importantly, from what we observed during the debate on tax reform, we are not convinced that more than a handful of individuals on Capitol Hill and at Treasury had any idea what Section 89 was all about at the time of passage. It appears to us that the Section 89 controversy has all of the same elements of the auto-log fiasco of just a few short years ago. The concept sounds good, but no one had the time to consider fully the complexities of implementation or the ramifications of compliance and enforcement. The effective date has rolled around, and we are forced to address the problem head-on.

We believe our problems with Section 89 can be divided into three categories — our disagreements with certain fundamental statutory assumptions of the section, questions of interpretation, and matters that could easily be resolved by better planning and communication by the government.

It has been our philosophy, in recent years, to make every effort to disseminate information to small business on new regulatory programs as quickly as we can. We do this through compliance guides and seminars. The Immigration and Naturalization Service's (INS) I-9 program and OSHA's Hazardous Communication (HCS) program are two examples of programs for which SBLC undertook major education initiatives. We believe it is our responsibility to accept the mantle of leadership and promote cooperation between the government and small business. On occasion, our efforts to educate reveal the flaws in these regulatory schemes. Today, we offer our comments on Section 89 with the voice of experience.

We have prepared a compliance guide to Section 89 and have already held one seminar on the subject. The results of our seminar, our work on the guide, and the thousands of calls received by our 95 member associations from their small business members lead us to the following observations.

First, let us state that we strongly support repeal of Section 89. For the reasons stated below, we believe repeal is the only solution. Before we state our substantive objections, we would like to comment on one "procedural" matter.

Undoubtedly, in the course of the debate on whether Section 89 should be repealed, revised or left alone, some will introduce the issue of revenue neutrality, specifically how do you pay for repeal? While we are as concerned as the next person about increasing taxes, we must not avoid addressing the substantive issue problems of Section 89 by becoming bogged down in a debate over revenue.

Section 89 was scored as a net "gainer" for the government in 1986. But how does the government benefit? It gains revenue if employers fail to comply, and if excessive benefit programs are maintained. Therefore, if employers comply with the apparent objectives of the proponents of the legislation, and do provide benefits equally to all, the government does not gain. It almost seems that the government's incentive is not to have businesses comply.

You would be hard pressed to prove to us that the government will gain revenue from this provision. It seems to us Section 89 produces two results, the least likely of which is that the employer maintains an excessive benefits plan. The more likely result is "compliance," resulting in no excessive income. This second result may be achieved, however, by an employer eliminating benefits, a result none of us would like to see.

Whatever the results, Section 89 is a revenue loser for another reason. The administrative expense of complying with Section 89 is a deductible expense. These expenses are projected to run into the thousands of dollars per small firm, regardless of whether they are likely to offer excessive benefits or not. Even if additional taxes are paid, they will be offset by these expenses. The bottom line is revenue neutrality should not be the issue here.

In the category of disagreements with the statutory concepts behind Section 89, putting aside the question of whether the government should regulate benefits, the most dramatic and unprecedented change brought about by Section 89 is the premise that individuals working 17 and one-half hours or more a week are to be considered employees for the purpose of benefits. This is a startling expansion of the concept of employment, with ramifications for not only this program, but for other potential government imposed responsibilities. The 1988 Technical Corrections Act included a special two-year transition rule on this point, but it does nothing to lessen the impact of this unprecedented expansion. We fear it may lead to the elimination of the part-time jobs, essential points of access into the work force for many individuals.

Second, we believe any regulatory scheme should allow small business owners an opportunity to bring their programs into compliance. Whether it is the OSHA HCS program or Section 89, the penalties should be prospective, contingent upon failure to comply within a certain time frame once an agency has served warning upon the individual company.

Third, we believe that Congress should not require small businesses to jump through the "hoops" at every turn. Once a small business owner has brought his or her program into compliance, the owner should be permitted to rely on its efforts without going through the machinations necessary for compliance, year in and year out. In effect, we need a "stand-still" agreement with the government, good for a period of time.

With regard to questions of interpretation, the laundry list of our concerns is long. We see many problems, and the regulations issued by the IRS only serve to graphically illustrate the unrealistic demands imposed upon small employers by Section 89.

For example, the requirements imposed by the "legally enforceable" demand ongoing evaluation and judgement by a business owner. Small business owners need a simple, direct answer. Do I have a legally enforceable plan or not? Under the regulations, we submit, small business owners would wake up every morning asking themselves is my plan legally enforceable.

Small business owners deal in direct costs. Comparisons of benefits received or valuations of benefits that are not based on fixed dollar-and-cents costs to the employer are meaningless to most small business owners.

Calculations that require small business owners to account for individuals no longer on the payroll, double or triple the amount of time an employer must spend on compliance. In the end, we believe Congress will find very little in the way of "discrimination" in the provision of the benefits in question by small businesses. Frankly, they do not have available to them the range of options available to create a discriminating plan. It generally comes down to what is available in the market and what can I afford.

The final problem we have with Section 89, was the lack of effective communication by the government. Congress and the IRS must ensure that small business owners understand their responsibilities before the effective date and this communication must consist of more than notice of the effective date.

While not perfect, the INS' I-9 program is a good model of how to communicate. The INS did undertake a major effort to inform the business public of the requirements through the dissemination of written and video material. In fact, if I recall correctly, the INS used the IRS list of business establishments for distribution of this information.

In the case of Section 89, there were some ways to reduce the likelihood of mass hysteria. For example, most small business owners automatically assume Section 89 applies to all benefits. They assume it applies to automobiles, vacations, tickets to events or memberships in clubs. Clear, simple information, in advance would have eliminated some major headaches. Unfortunately, small businesses are still working to comply with the relatively recent changes in fringe benefit rules, and in many instances do not fully understand which benefits are includible or excludible from the employee's income. This confusion includes the proper application of definitions of working condition fringes and de minimis fringes. For this reason, we found it necessary to describe the fringe benefit rules in our guide. We believe early dissemination of this type of information is essential.

Realistically, no amount of change will make Section 89 an easy test with which to comply. It seems to us that Congress rarely says, "Thou shall not do the following..." Instead, it appears drafters attempt to anticipate every possible way to circumvent the law, plausible or implausible, and include language to prevent such activity. The results are laws too complicated that penalize owners, who in good conscience, wish to comply. A recent law suffering from the same phobia that comes to mind, is the plant closing notification act. The irony is that complicated regulatory requirements create an underground community of owners who say, "This is just too difficult, I'll take my chances and wait to see if they catch me." We do not want that to happen, and we believe most small business owners do not want it. We know some owners will eliminate jobs in reaction to Section 89. Others will simply eliminate every employee's benefits. The way to ensure compliance is to be realistic and flexible in the development of laws and regulations. Is that not why this Committee was instrumental in the passage of the Regulatory Flexibility Act? We believe it is time Congress applied the Regulatory Flexibility Act to itself. Specifically, we believe it is time for Congress to require standing committees to undertake a careful review of the economic impact of proposed legislation upon small business before the committee votes on legislation. In the last Congress, such a proposition gained some attention in the midst of the debate over various labor bills. We submit that if Congress undertook the economic analysis of the type required by the Regulatory Flexibility Act there would be no Section 89's.

We find a new undercurrent within the small business community. Under the patina of optimism, lies a layer of frustration. For the first time in a decade, we have heard small business owners suggest the price of doing business is just too high, and the price of doing business is paperwork and regulation. In this nation, we assume entrepreneurship has perfect elasticity; that is, no matter what the cost of entry, more Americans will want to own the American dream. It may not be so. A few examples of the relatively new regulatory schemes with which small business must comply include the I-9 program imposed by the Immigration Reform and Control Act; the

Hazardous Communication Standard Program; the underground storage tank program; the hazardous waste program created by the RCRA; several other tax compliance items, such as the passive/active rules; new transportation licensing requirements; plant closing notification rules; polygraph-use restrictions and notice; and, new credit card disclosures. State and local governments have also initiated unprecedented oversight of business.

We do not want to be whiners. Small business has always taken the attitude, "We'll survive it." The question to ask is — if small business is so important to our economy, why do we always force the question? Let's let them go about the business of doing business, not government homework. Thank you.

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PHONE NO.: (202) 639-8500 / FAX NO.: (202) 347-4777

UNRAVELING THE MYSTERIES OF SECTION 89:

A Business Owner's Guide to Providing Employee Benefits Under The Tax Code

SMALL BUSINESS
LEGISLATIVE
COUNCIL

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INTRODUCTION

In 1986, Congress made the decision to encourage employers to provide benefits to all workers, equally, regardless of compensation. The result of Congress' efforts is Section 89.

Simplicity and complexity are in the eyes of the beholder. Like many regulatory schemes, Section 89 is written to take care of the extremes, rather than the commonplace. This guide is for informational purposes only. It is not a substitute for legal or accounting advice. *We urge the reader to always consult the IRS regulations.*

Many pages have been written about the Section 89 rules. One whole set of regulations is needed just to explain compensation. In writing this guide, we chose the middle path. We chose to *highlight* the typical situation.

For many businesses, Section 89 may require very little except a few minutes of thought and planning. If you have some doubts, or offer sophisticated benefits, hopefully this guide will at least identify the questions you need to ask, and we recommend you seek further guidance from counsel.

The Technical Corrections Act of 1988 directed the U.S. Department of Treasury to issue comprehensive guidance with respect to Section 89 by November 15, 1988. The regulations were published on March 7, 1989.

With regard to its regulations, the IRS states:

> "These proposed regulations constitute the issuance of comprehensive Section 89 rules on which taxpayers may rely. Nevertheless, until the later of January 1, 1990, or the beginning of the second testing year beginning after December 31, 1988, if an employer reasonably and in good faith complies with the requirements of Section 89 (including the legislative history thereto), the employer will be treated as having satisfied Section 89. After this transition period, this standard of compliance will not apply to the extent that these proposed regulations address issues under Section 89. Whether compliance is reasonable and in good faith is to be determined on the basis of all the facts and circumstances, including whether the employer makes a reasonable and good faith effort to collect and analyze the necessary data and information, and whether the employer consistently resolves unclear issues in its favor."

"This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought."

CHAPTER I

WHO'S COVERED?

Our objective is to simplify as much as possible the process of compliance; therefore the following basic questions will lead you to the appropriate chapters, and hopefully may relieve you of any further reading.

Do you offer any benefit of any kind to any employees that is not included in the employee's gross income? (If you are self-employed, you are an employee for these purposes.)

If the answer is no, close the book and relax, Congress did not make your life any worse today. If the answer is yes, proceed to the next question.

Do you offer any of the following benefits?:

[redacted]

If the answer is yes, we are sorry to report that hard work is ahead of you. This book is written principally for you. If the answer is no, but *you do offer other fringe benefits* such as employee discounts or an employer-operated eating facility, ***please read Chapter II only.***

Do you participate in a multi-employer plan, operate separate lines of business or maintain multiple facilities? *Do not overlook Chapter VII.*

Do you offer a package of benefits from which employees choose (cafeteria benefits plans)? *Do not overlook Chapter VII.*

CHAPTER II

ALL BENEFITS PROGRAMS — QUALIFICATION RULES

BASIC REQUIREMENTS

Whenever an employer provides a benefit under:

A statutory employee benefit program (*see Chapter III*);

A qualified tuition reduction program;

A cafeteria plan (*see Chapter VII*);

A fringe benefit program such as those providing no-additional-cost services, qualified employee discounts, or employer-operated eating facilities; or,

A voluntary employee benefit association (VEBA);

then the employer must ensure that:

The plan is in writing;

The employees' rights under such plan are legally enforceable;

The employees are provided reasonable notification of benefits available in the plan;

The plan is maintained for the exclusive benefit of employees; and,

The plan was established with the intention of being maintained for an indefinite period of time.

FRINGE BENEFITS

It is essential to remember that these qualification rules applies only to those fringe benefits that are *excludible* from the employee's gross income under the tax law.

It is important for employers to remember that certain benefits must be reported as income to the employee under other sections of the tax code, but, as a result, are not subject to the Section 89 qualification rules.

Examples of fringe benefits includible in gross income, and; therefore, *not subject* to the Section 89 qualification rules, are:

[redacted]

Examples of fringe benefits that may be excludibie from income, and; therefore, *subject* to the Section 89 qualification rules are:

[redacted]

If you offer an employee a service free of charge or at a reduced price that is the same service you offer to non-employees in the ordinary course of the line of business in which the employee works, this service is considered a ***no-additional-cost service*** and may be excludible from the employee's income. You cannot incur substantial additional cost, including lost revenue, in providing the service to an employee. Examples of these services are: excess airline, bus, or train tickets, unused hotel rooms, or telephone services provided free or at a reduced price to employees working in those lines of business.

Generally, an employer's line of business is determined by reference to the Enterprise Standard Industrial Classification Manual (ESIC Manual) prepared by the Statistical Policy Division of the U.S. Office of Management and Budget.

Employees may be able to exclude no-additional-cost service benefits provided by another employer in the same line of business if you and the other employer have a written *reciprocal agreement* and the no-additional-cost service requirements are met. For example, two related airlines provide free space-available flights to each other's employees. If the requirements of a no-additional-cost service listed above are met, the value of the flights can be excluded from the recipient employees' income.

A qualified employee discount is a reduction in price that you offer employees on certain property or services which you offer to non-employees in the ordinary course of the line of business in which the employees perform services. Personal property held for investment or real property does not qualify for a discount. The discount (for property) may not exceed your gross profit *percentage* and, for services, may not exceed 20 percent of the price at which the service is offered to non-employee customers. The gross profit percentage is determined on the basis of all property offered to customers (including employee customers) in the ordinary course of the line of business, and your experience during a representative period. To figure the gross profit percentage, subtract the total cost of the property from the total sales price of the property and divide the remainder by the total sales price of the property.

Any property or services you provide to an employee may be excludible as ***working condition fringe benefits*** to the extent the employee could deduct them as business expenses had the employee paid for them. If the payment would be deductible in a business of the employee, other than your business, you cannot treat the payment as a deduction for purposes of determining the amount, if any, of the working condition fringe. Also, the value of parking facilities provided to employees on or near your business premises may be excluded even though not deductible by the employees.

A de minimis fringe is any property or service you provide to an employee (taking into consideration how frequently similar fringe benefits are provided to your other employees) that has so small a value as to make accounting for the benefit unreasonable or administratively impracticable. Examples: typing of a personal letter by a company secretary; occasional personal use of a company copying machine; monthly transit passes provided at a discount not in excess of $15; occasional parties or picnics for employees; occasional supper money and taxi fare for employees working overtime; holiday gifts with a low fair market value; occasional tickets for entertainment events; and coffee or doughnuts furnished to employees.

The value of meals provided to your employees at an employer-operated eating facility may be considered a de minimis fringe, if the annual income from the facility normally equals or exceeds the direct operating costs of the facility. For more information, including definitions of an employer-operated eating facility and direct operating costs, see the IRS' Valuation of Meals Provided at an Employer-Operated Eating Facility for Employees. (This free publication is available from the IRS.)

Your employees may exclude from gross income the value of an ***on-premises gym or other athletic facility*** provided and operated by you, if substantially all the use during the calendar year is by employees, their spouses, and their dependent children. The value of the use of country clubs or health clubs that are open to the public is not excludible unless the above requirements are met. The exclusion does not apply to any athletic facility that is a facility for residential use. For example, a resort with athletic facilities would not qualify.

EXPLANATIONS

For most small employers, compliance with the qualification rules will be required as a result of a statutory employee benefit plan such as a health plan, or a fringe benefit such as an employee discount.

The term "benefit" or "benefits" means those payments, reimbursements, products, and services provided under the plan to a participant on account of such participant's claim, need, or event that is covered under the plan. For example, the fair market value of the use of an on-site child care facility by a participant is the benefit under a dependent care assistance program. Similarly, reimbursement of a participant's expense incurred for a covered surgical procedure is a benefit under a health plan. Another example of a benefit under a plan is the payment of a death benefit under a group-term life insurance plan.

The term "employer-provided benefit" means that portion of the benefits received by an individual that is attributable to employer contributions, including salary reduction contributions under a cafeteria plan.

A plan "maintained by an employer" is any plan of, or subsidized by, an employer who employs participants in the plan. A plan is maintained by an employer even if the cost of such plan is borne by the employees through after-tax employee contributions, as long as the value of the coverage under the plan for any employee is greater than such employee's after-tax contributions. The term "employee" includes the spouse and dependents of the employee.

Sick pay plans and disability plans are subject to the qualification rules only if employer-provided benefits under such plans are excludible from gross income upon receipt by the individual under the proper code section. Workers' compensation plans are *not* covered. Plans to which Section 89's non-discrimination rules apply (e.g. health) must also comply with the qualification rules.

WRITTEN DOCUMENT

The requirement that a plan be in writing must be met by a single document. One such document may satisfy the writing requirement for more than one plan.

Written documents relating to the plan are treated as part of the single written document if they are specifically incorporated by reference in the single written document. The single written document must either contain all of the plan's material terms or, to the extent a material term is not contained in the single written document, incorporated by reference.

The written plan should include items such as:

Material terms of the plan;

A description of each benefit available;

The names of the trustees or other fiduciaries of the plan;

The class of employees eligible to participate;

A statement that the plan is for the exclusive benefit of the covered employees; or,

A statement that the employees' rights are legally enforceable.

Examples of documents which may be incorporated in the single written document are:

Contracts with insurance providers;

Contracts with any other provider of benefits under the plan;

Contracts with plan administrators of, or consultants to, the plan;

Documents creating a trust or other funding instrument related to the plan;

Resolutions of the employer's governing body relating to the creation, operation, maintenance or termination of the plan;

Collective bargaining agreements;

Pronouncements made by the employer, an agent of the employer, a plan administrator or other person relating to or concerning a material term in the plan; or,

All plan-related documents required to be provided to any employee or filed with any regulatory agency or instrumentality of any federal, state, or local governmental body by statute, rule, or regulation, including but not limited to the documentation required to be provided to employees by Section 89's notice requirement.

A plan is __not__ required to meet the writing requirement with respect to the first plan year beginning in 1989. For the subsequent plan year, a plan is not required to meet the writing requirement before the later of the first day of such plan year, or the day following the end of the 12-month period beginning on the first day of the first plan year in 1989 that the plan is subject to Section 89.

LEGALLY ENFORCEABLE

A plan is considered legally enforceable only if the conditions required for an employee to participate, receive coverage and obtain a benefit are definitely determinable under the terms of the plan, and an employee satisfying such conditions is able to compel such participation, coverage and benefit.

A plan generally is not considered legally enforceable if a decision as to whether to grant or deny participation, coverage or a benefit is within the employer's discretion. An employer is deemed to have exercised discretion in a manner inconsistent with the rules if the employer imposes conditions or limitations on eligibility for coverage that are not contained in the single written document comprising the plan, and have not been included in the notice to the employees. Likewise, if the employer waives an otherwise applicable condition, restriction or other term contained in the plan, it violates the legally enforceable rule if the single written document does not contain objective, clearly ascertainable criteria and procedures under which such condition, restriction or term may be waived. Finally, a plan violates the rules if participation, coverage or benefits under the plan are subject to objective conditions that are within the control of the employer.

A plan may permit discretion with respect to the administration of the plan, including the application of objective criteria specifically set forth in the plan. In addition, a plan does not fail to meet these requirements merely because discretion is exercised in accordance with a qualified medical opinion of a physician. Also, if plan coverage or benefits are limited to those employees who satisfy certain objective conditions that are clearly set forth in the single written document and are not generally subject to the employer's discretion, an employer may exercise discretion to the extent reasonably necessary to determine whether the objective conditions have been met.

Administrative discretion means a determination by the employer with respect to participation in, or coverage or benefits under a plan. Administrative discretion is permissible with respect to the general operation of a plan, to the extent the exercise of such discretion is based exclusively on clearly defined and ascertainable criteria contained in the single written document.

The following are examples of provisions which permit limited administrative discretion, that may be permissible under the law:

A provision allowing for the commencement of benefits under the plan as soon as administratively feasible after a stated date or event;

A provision granting the employer authority to determine whether an employee has satisfied the age and service requirements of the plan or is an excludible employee; and,

A provision stating that the benefits under the plan are limited to an amount equal to the reasonable and customary charge for such services.

A health plan does not fail to be legally enforceable merely because coverage or benefits under the plan are conditioned on a qualified medical opinion of a physician. Examples:

The requirement of a qualified medical opinion of a physician that treatment or benefits are medically necessary or appropriate prior to the provision of such treatment or benefits under a health plan

The requirement of a second opinion or other cost-containment feature of a health plan that is conditioned on a qualified medical opinion of a physician

The inclusion under the plan of a managed care program (this is the case even if the qualified opinion is provided by a physician who is an employee of the employer)

A ***health plan*** that limits certain benefits, such as reimbursements, for specified medical claims to those benefits that constitute the "prevailing" or "reasonable and customary" charge for the claim may be permissible. In addition, a health plan that reimburses medical claims in excess of a "prevailing" or "reasonable and customary" charge if such reimbursements are authorized in accordance with reasonable, uniform, consistent, and nondiscriminatory claims review and reimbursement procedures set forth in the single written document, may be permissible.

A ***managed care program*** is a program that permits the provision of alternative medical care not otherwise available under a health plan, for medical conditions that are covered under the plan. The availability of the program as well as a description of the types of cases that may qualify under the program must be contained in the single written document. Also, the provision of alternative medical care must be based on the consent of the employee and a qualified medical opinion of a physician. Such program may also be conditioned upon the consent of the employer.

MATERIAL TERMS

The phrase "material term of a plan" generally means a term relating to an employee's rights to be covered by, participate in, or benefit under a plan.

The following are examples of material terms of a plan:

The eligibility rules governing plan participation;

Descriptions of available benefits;

The procedures governing participants' elections under the plan, including the period during which an election may be made, the extent to which elections are irrevocable, and the periods with respect to which elections are effective;

The manner in which employer contributions may be made under the plan, such as by salary reduction agreements between a participant and the employer and by non-elective employer contributions, as well as any maximum limitation on employer contributions on behalf of any participant;

Terms relating to the periods during which coverage or benefits are provided;

Terms relating to the timing or amount of salary reduction or employee contributions to the plan;

Terms relating to deductibles, co-payments or similar requirements, including any dollar limit on any benefit;

Conditions precedent or subsequent with regard to a participants' qualification or continued qualification for any coverage or benefit, including any limitations or restrictions relating to benefits, such as a pre-existing condition limitation;

Provisions relating to the procedure under which claims are to be made and evaluated for reimbursement;

Provisions relating to health continuation coverage under Internal Revenue Code Section 4980B; and,

The procedures or circumstance under which the plan may be terminated, including a statement, if applicable, that the plan may be terminated at will by the employer.

The IRS regulations provide rules for the modification of material terms.

INDEFINITE TIME

A plan generally is treated as established, with the intent that it will be maintained for an indefinite period of time, if it is established and maintained for at least a consecutive 12-month period.

In certain circumstances, significant modifications in the coverage or benefits under the plan, or a termination of coverage or benefits, raises a presumption that the plan was not established with the intent that it continue for an indefinite period of time. A plan is not considered to be modified or terminated merely because of a change in the insurance carrier or health care provider if the coverage and benefits under the plan are not substantially changed.

Although the rule requires that plans be established for an indefinite period of time, plans may be terminated for business necessity reasons such as:

[illegible]

NOTE: No-additional-cost services and qualified employee discounts are exempt from the indefinite time requirements.

REASONABLE NOTIFICATION OF EMPLOYEES

Notice to the employees must include a fair and complete summary of the material terms of the plan that are reasonably likely to be of significance to an eligible individual. These terms include at least the following:

A general description of who is eligible to participate in the plan;

A general description of the coverage or coverages offered (including the general types of benefits provided under the plan, basic limitations on such benefits, and required deductibles and co-payments);

The timing and method of any election to participate;

The cost to the employee relating to the plan, whether by way of salary reduction or employee contributions;

The method by which a copy of the plan may be obtained; and,

The name and means of contacting a person from whom to request further information about the plan.

The notice must contain a statement that the employer (or the plan administrator, if the plan is a multi-employer plan) shall make the single written document (including all related documents incorporated therein by reference) available for inspection upon reasonable notice.

For any plan other than an accident or health plan, in lieu of the above notice, the employer (or plan administrator, if the plan is a multi-employer plan) may furnish each eligible individual with a copy of the single written document and all related documents that have been incorporated by reference. This alternative cannot be used unless the single written document complies in all material respects with the requirements of 29 CFR Section 2520.102-2 (style and format of summary plan description).

If the employer elects to notify eligible individuals through the use of the alternative method, the notice must be provided to each such eligible individual either by hand or by mail with first class postage prepaid to the last known address of the eligible individual.

At a minimum, the following individuals shall be entitled to inspect and copy the single written document:

Any eligible individual;

Any other employee of the employer maintaining the plan; and,

Any employee organization that represents employees of such employer.

The document must be made available at no cost to the requesting individual at a reasonable time and place and, if a copy of the document is requested, a copy is to be provided at a cost no greater than that prescribed by the applicable government rules.

While notification to eligible individuals must be provided by the employer (or the plan administrator, if the plan is a multi-employer plan), notice that otherwise meets these requirements and is provided by an insurance company, health maintenance organization or other health care entity is considered to be provided by the employer. Notice must be provided to all eligible individuals (other than those individuals deriving their eligibility solely through another individual, such as dependents who derive their eligibility in a health plan through an employee).

The notice required must be provided prior to the first day on which coverage is provided, or benefits are available, and prior to the effective date of any material amendment, extension or modification of such coverage or benefits, and no later than a reasonable time prior to the availability of any election with respect to participation under such plan. The first date on which coverage is provided, or benefits are available, is the earliest date on which a claim may be incurred and be covered under coverage provided under a written document in existence on the date the claim is incurred.

If there is a modification to a material term of a plan, eligible individuals must be provided with notice of such modification no later than 60 days after the effective date of the modification.

If an employee's participation in a plan is non-elective and begins within the employee's first 60 days of employment, the notice to such employee is not required prior to 60 days after the first day such employee is employed.

With respect to a plan year beginning on or after January 1, 1989, a plan is not required to comply with these notice requirements until the later of July 1, 1989, or the first day of such plan year. Use of this specific transition rule does not accelerate the first date by which the plan must meet the writing requirement.

REPORTING REQUIREMENT

If the employer fails to meet the qualification rules, the value of the benefits is includible in the gross income of the employee (*see chapter VIII*). In such a case the amount must be separately stated on the employee's Form W-2.

SANCTIONS

See Chapter VIII.

CHAPTER III

STATUTORY BENEFITS

INTRODUCTION

Congress has made the determination that certain benefits, called "statutory" benefits, should be offered to all employees regardless of the level of compensation. Congress, however, did *not* prohibit the offering of benefits to some employees and not others, rather Congress constructed an elaborate mechanism which ultimately requires the recipient of the "extra" benefit to pay tax on those benefits which he or she receives that others do not. Complexity is generated by the effort to determine whether the benefits are offered on a discriminatory basis. In this chapter, we will provide definitions essential to making the determinations of discrimination.

Under this regulatory scheme, employees are divided into two categories: highly compensated employees (HCEs) and non-highly compensated employees (NHCEs). In the case of Section 89, there are four tests, which are laid out in Chapter IV. Basically, the tests compare the eligibility of, and the benefits received by, the HCEs versus the NHCEs. Congress did not require that the benefits be *exactly* equal; rather there are permissible ratios. If the benefit plans fail the tests, the HCEs are taxed on the difference to which the benefits exceed the permissible ratio.

The first steps, then, are to determine if your benefit plan is a "statutory benefit plan" to which the rules apply; determine which of your employees can be excluded from the computations; and, determine which employees are HCEs or NHCEs.

WHAT BENEFITS ARE STATUTORY BENEFITS?

An employer *must* comply with Section 89's non-discrimination rules if the business offers to its employees:

accidental and health plans

group-term life insurance

At the employer's option, an employer *may* comply if it offers:

ducation assistance
lans
ependent care assistance
lans
ualified group legal
ervices plan

The rule does not apply to disability coverage, such as sick pay or disability plans, unless the benefits of such coverage are excludible from gross income for tax purposes.

Business travel accident insurance is covered, as are plans that provide for medical diagnostic procedures or physical examinations. Generally, workers' compensation plans are *not* covered.

HIGHLY COMPENSATED EMPLOYEES (HCE)

A highly compensated employee is:

A five-percent owner of the business; or

An employee who received more than $75,000 in annual compensation; or

An employee who received more than $50,000 and is in the top 20 percent of employees by compensation; or

An officer of the employer earning $45,000 or more.

An employer, however, may elect to use a simplified method. If the employer maintains significant business operations in at least two significantly separate geographic areas, the employer may simply treat any employee receiving $50,000 or more as an HCE.

A five-percent owner must include any ownership interests of his/her spouse, children or parents.

Compensation includes wages, bonuses, commissions, tips and so forth. Generally, it is an all encompassing definition with the exception of non-elective employer contributions to pension-type plans.

NOTE: If an employer has only highly compensated employees, then Section 89's non-discrimination tests do not apply.

PART-TIME EMPLOYEES

Employees who *normally* work less than 17 and one-half hours per week are disregarded in applying the non-discrimination rules. "Normally" is defined as the average number of hours worked during the testing year prior to the testing date. If that period is less than 60 days, the employer must go back to the prior testing year. If an employee did not work 60 days in that prior testing year, the employer looks to hours scheduled to work during the next 60 days or the period of time between the testing date and the end of the testing year. (See Chapter VI for the determination of testing date and testing year.)

Scheduled hours determinations are to be made in good faith and are to take into account cyclic-seasonal factors.

A special transition rule permits employers that normally employ fewer than 10 employees to exclude part-time employees who work less than 35 hours in 1989, and 25 hours in 1990.

EXCLUDIBLE EMPLOYEES

The following employees shall be excluded for the purposes of Section 89:

Employees who have not completed one year of service (or in the case of core benefits under a health plan, six months of service);

Part-time employees (see previous section - 17 and one-half hours or less);

Employees who normally work *not* more than six months during any year;

Employees who have not attained age 21; and,

Employees covered by a collective bargaining agreement.

In order for the employer to exclude an individual on any of these grounds, all employees meeting the criteria must be excluded as well. The employer cannot pick and choose.

FORMER EMPLOYEES

In the future, if former employees continue to receive benefits under a plan, they will be included in the calculations for the non-discrimination tests. If they were not employed as of January 1, 1989, however, they may be disregarded for the non-discrimination tests.

CAVEAT: If there is a benefit reduction or increase for former employees who ended their employment before January 1, 1989, and if the increase or decrease is not uniform for all, the benefits may have to be tested.

SELF-EMPLOYED

A self-employed individual will be considered an employee for the purposes of the Section 89 tests.

CHAPTER IV

THE TESTS FOR STATUTORY BENEFIT PLANS

INTRODUCTION

The heart of Section 89 is four non-discrimination tests for employee plans. Three of these tests relate to eligibility, the fourth is a benefits test. A key point in administering these tests is that even if an employer offers the opportunity to employees to participate on a non-discriminatory basis, the plan may fail the test if the employees choose not to participate.

PLANS

The definition of what constitutes a plan may be one of the most elusive aspects of Section 89. In 1986, Congress said: "Each different option generally is a separate plan for testing purposes. This means, for example, that if two types of insurance coverage vary in any way (including the amount of required employee contributions), they are considered separate plans." In 1988, Congress amended Section 89 in the Technical Corrections Act, and said: "Each different option is valued separately, but is not considered a separate plan. A plan is a group of options with comparable values (under otherwise applicable comparability rules). With respect to the non-discrimination rules, the effect of these changes is only one of terminology rather than of substance."

The IRS regulations state that a health plan is a uniform entitlement provided to employees with respect to payments on account of personal injury or sickness, including specified medical claims, expenses, products or services. Any difference in entitlement creates separate health plans. In addition, any difference in cost to different groups of employees, including the fact that salary reduction contributions are required for coverage that is identical to coverage that is otherwise employer-provided, creates separate plans. Each option as to coverage is treated as a separate health plan for purposes of Section 89.

Given the new aggregation and comparability rules that are described below, it does appear the outcome will be the same whether the definition of a plan is narrowly or broadly construed.

If two or more plans are identical in all respects except for the group of employees covered, they may treat them as a single plan even if they are governed by separate documents.

If the difference in plans relates only to the number of hours worked, there is a special rule for proportionate reductions and the plans may be treated as a single plan.

In comparing the benefits of a class of employees to the benefits of another class of employees, the employer may be permitted to disregard any ancillary benefits that are required by state law for one of the classes but not for the other.

The significance of these distinctions relates to the application of the various tests described below. In the case of the 90/50 test or the benefits test, all plans of the same type are aggregated. In applying the 50-percent test or the alternative 80-percent test (described later), it is necessary for the plans not only to be of the same type but to be within a certain comparability range. The comparability range is explained below.

LIFE INSURANCE PLANS

Group-term life insurance that varies in proportion to compensation will be considered a single plan. Employers may use any non-discriminatory definition of compensation, not only in testing years beginning after December 31, 1990, but also in testing years beginning in 1989 and 1990. A definition of compensation will be considered non-discriminatory for purposes of applying Section 89 to group-term life insurance only if the ratio of (1) the average compensation of the non-highly compensated employees under the definition to (2) the average compensation of the non-highly compensated employees is at least 100 percent of the same ratio for highly compensated employees. Employers also have the option of using base compensation, thereby disregarding bonuses and overtime.

There are two additional exceptions to the general rule that if two types of insurance coverage vary in any way, they are considered separate plans. If, with respect to group-term life insurance coverage, the required employee contributions vary according to the age of the employee, this variation does not preclude treatment of the coverage as a single plan. Thus, for example, if an employer offers every employee group-term life insurance coverage equal to one times compensation, provided that the employee contributes one quarter of the cost of such coverage, this constitutes a single plan even if the cost of each employee's coverage is determined on the basis of such employee's age.

Under the second exception, if, with respect to group-term life insurance coverage, the required employee contributions vary according to the age of the employee, but only up to a specified limit (e.g., the employee's cost may not exceed $X per $1,000 of coverage), this variation does not preclude treatment of the coverage as a single plan. (Under this exception, the employer either may establish a limit up to which age rating applies fully or may phase the age rating out gradually.) The use of age brackets of up to five years is permitted under both exceptions. Thus, for example, an employer could establish a series of five-year age brackets and have the required employee contributions only increase when an employee moves from one bracket to another.

If an employer uses the first exception described above, and employee-purchased coverage is not treated as employer-provided, then the amount of employer-provided group-term life insurance coverage with respect to any employee is the amount that bears the same relationship to the total coverage for such employee as the employer's contribution (determined on an age-rated basis) bears to the age-rated cost of such employee's total coverage. For example, if an employee contributes one quarter of the age-rated cost of $100,000 of coverage, and employee-purchased coverage is not treated as employer-provided, the employer-provided group-term life insurance coverage with respect to such employee is $75,000.

If an employer uses the second exception described above and employee-purchased coverage is not treated as employer provided, then the amount of employer-provided group-term life insurance coverage with respect to any employee is determined in the same manner as with respect to the first exception, except that the employer contribution and the total cost of the employee's coverage are calculated on an age-rated basis subject to the specified limit (and to the phase out of age rating if applicable).

If the employer does not use either of the exceptions described above, and employee-purchased coverage is not treated as employer-provided, the amount of employer-provided group-term life insurance coverage with respect to any employee is determined in the same manner except that the total cost of any employee's coverage and the employer's contributions with respect to such coverage are to be determined without regard to the employee's age.

For purposes of the 90-percent/50-percent test and the 75-percent test (as described below), the employer may use the general definition of a group-term life insurance plan or one of the two exceptions despite the fact that the employer did not use the same definition for purposes of applying the 50-percent test to any particular plan.

THE TESTS

In general, an employer has two approaches to non-discrimination testing under Section 89. Under the first approach, an employer's employee-benefit plan will meet the Section 89 requirements only if:

At least 50 percent of the employees eligible to participate in a plan are NHCEs;

At least 90 percent of the NHCEs are eligible to participate in the plan(s) that, on an aggregate basis, are at least 50 percent as valuable as the combined value of the plans of the same type that are available to any HCE; and,

The average benefit received by NHCEs under all plans of the same type is at least 75 percent of the average benefit received by HCEs.

Under the second approach, an employer's employee-benefit plan satisfies the requirements of Section 89 if it benefits at least 80 percent of the employer's NHCEs.

CAUTION: Salary reduction contributions can effect the outcome of some tests. Generally, the portion of the value of health coverage that is attributable to salary reduction contributions is treated as attributable to employer contributions and thus as an employer-provided benefit. (Consult the IRS regulations.)

THE 50-PERCENT TEST

Under the 50-percent test, non-highly compensated employees (NHCEs) must constitute at least 50 percent of the group of employees *eligible* to participate in the plan. Two or more health plans included in a group of comparable plans may be treated as a single health plan. A group of plans is comparable if the smallest employer-provided benefit available to any employee in any plan in the group is at least 95 percent of the largest employer-provided benefit available to any employee in any plan in the group.

However, before applying this rule, if the employee may receive coverage under two or more health plans, such plans must be aggregated into an additional, single health plan that provides all of the coverage provided under any of the separate plans. The additional plan is treated as having an employer-provided benefit equal to the sum of the employer-provided benefits of each of the included plans. A NHCE is treated as eligible for both the additional plan and the separate plans. A HCE is treated as eligible only for the additional plan and is no longer treated as eligible for the separate plans.

The exception to the general rule is when the percentage of HCEs eligible, compared to the [illegible] f HCEs in the business, does not exceed the percentage of NHCEs eligible compared to the total NHCEs in the company. For example, if an employer has 20 employees, 15 of which are HCEs, and *all* employees are eligible for the program, NHCEs constitute only 25 percent of the group eligible to participate, but since all NHCEs (100 percent) are part of the group, the percentage of HCEs (100 percent) does not exceed the NHCE percentage and the 50-percent test is deemed to have been met.

If an employee is eligible for coverage under more than one accident or health plan, then, for purposes of the 50-percent test such plans are required to be considered one plan with respect to such employee. For example, assume that an employer maintains two plans; one benefiting all employees with a value of $950, and a second benefiting only highly compensated employees with a value of $1,000. Highly compensated employees receiving benefits from both plans are to be treated for purposes of the 50-percent test as receiving $1,950 of benefits from one plan while the non-highly compensated employees are to be treated as receiving $950 of benefits from a separate plan.

THE 90-PERCENT / 50-PERCENT TEST

The test simply stated is that at least 90 percent of the employer's NHCEs must be eligible, not only for the plan, but for a benefit that is at least 50 percent as valuable (see Chapter VI for valuation rules) as the benefit available to HCEs. Plans of the same type may be aggregate. Benefits paid for by salary reduction arrangements generally may be disregarded when determining the value of available benefits for the purpose of this test. The following example illustrates the 90/50 rule.

> A firm has 65 employees, 50 NHCEs and 15 HCEs, 45 of the NHCEs are eligible for health plan coverage. Ten of the NHCEs have coverage valued at $1,500, while 20 have coverage valued at $1,000; 5 have $750 worth of coverage; 10 have $500; and 5 are not eligible for any coverage. All of the firm's 15 HCEs are eligible for coverage: 5 have $2,000 in coverage, another 5 have $1,500, and the final 5 have $1,000.
>
> Although 90 percent of the NHCEs are eligible for the plan, it fails the test because only 60 percent of the NHCEs (i.e., those with coverages of $1,500 and $1,000) have a benefit that is at least 50 percent of the largest benefit provided to an HCE (i.e., the $2,000 benefit provided to 5 of the firm's HCEs).

NON-DISCRIMINATION PROVISION

A plan may not contain any provisions relating to eligibility for participation that by its terms or otherwise discriminates in favor of HCEs. For example, if an employer provides unusual coverage for a rare condition to which only the owner of the business is subject, such coverage may fail this test.

75-PERCENT BENEFITS TEST

The average employer-provided benefit *actually provided* to NHCEs under all plans of the employer of the *same type* must be at least 75 percent of the average employer-provided benefit actually provided to HCEs. Accidental health plans may be aggregated with other plans to help meet the 75-percent test but *not* the other way around. This is true even if an employer elects to apply the 75-percent test separately to coverage of employees and coverage of employees' spouses and dependents. The average is calculated by dividing the aggregate benefits received by the employees in question, HCEs or NHCEs, by the total number of HCEs or NHCEs in the business whether or not they are covered by such plans.

$$.75 \quad x \quad \frac{\text{HCEs' benefits}}{\text{Total of HCEs}} \quad \leq \quad \frac{\text{NHCEs' benefits}}{\text{Total of NHCEs}}$$

The employer-provided benefit is the value of the coverage under the plan that is attributable to employer contributions. In the case of a health plan, the employer-provided benefit is the employer-provided portion of the value of the entitlement to receive payment on account of personal injury or sickness including medical care or reimbursements of specified medical expenses or other medical benefits, subject to various conditions and limits, rather than the value of the reimbursements, products, services and other benefits received pursuant to the health coverage. In the case of any other statutory employee benefit plan, an employee's employer-provided benefit under Section 89 is the employer-provided portion of the value of the reimbursements, products, services and other benefits provided under the plan (rather than the value of the coverage or the entitlement to such benefits). The following example illustrates the benefits test.

A firm has 60 employees, 50 are NHCEs and 10 are HCEs, and a health plan. Of the 50 NHCEs, 30 have coverage valued at $1,000; 15 have coverage valued at $1,500; and 5 have coverage worth $500. Thus, the average benefit provided to the NHCEs is $1,100 (i.e., $30,000 + $22,500 + $2,500 = $55,000; $55,000 ÷ 50 = $1,100).

The firm also has 10 HCEs; 5 of these highly paid workers receive $1,500 in coverage, while the other 5 receive $2,000. The HCEs average benefit amounts to $1,750 ($7,500 + $10,000 = $17,500; $17,500 ÷ 10 = $1,750).

To satisfy the 75 percent test, the average benefit provided to NHCEs must be at least 75 percent of the benefit provided to HCEs. Based on an average benefit of $1,100 for NHCEs, the allowable benefit for HCEs is $1,467 ($1,100 ÷ 0.75 = $1,467). However, since the actual average employer-provided benefit for the HCEs is $1,750, the plan fails the test because the HCEs benefit exceeds the allowable limit.

ALTERNATIVE 80-PERCENT TEST

Congress did create a safe harbor for meeting the 90/50 percent, 50 percent, and benefits tests by creating a single alternative test. If the employer can show that at least 80 percent of all NHCEs receive the benefit (*are actually covered by the plan*) then the plan will be considered as having met the tests. Eligibility to receive coverage is not considered benefitting under the plan. In order to conduct this test, the employer cannot automatically aggregate plans of the same type; rather the employer must comply with the following rules.

1) **General Comparability Range** - For purposes of the 80-percent test, a group of plans is comparable and may be aggregated if the value of the employer-provided coverage provided to each covered employee in the plan with the lowest such value is *at least 90 percent* of the value of the employer-provided coverage provided to each covered employee in the plan with the highest such value. The comparability standard is *reduced to 80 percent* if the employer elects to apply the 80-percent test as a 90-percent test.

2) **Plans Outside the General Comparability Range** - For purposes of the 80-percent test, a plan with a value greater than that permitted under the general comparability rule may be aggregated with a group of less valuable comparable plans if the employees covered under the plan with the greater value is at least 80 percent (90 percent if the 80-percent test is applied as a 90-percent test) of the percentage of highly compensated employees covered under such plan.

3) **Comparability Safe Harbor** -

   a) Under the general safe harbor rule for purposes of the 80-percent test, a group of plans is treated as comparable with respect to a group of employees if:

      (i) such plans are available on the same terms to all employees within the group, and

      (ii) the difference in annual cost to the employees between the plan in the group with the smallest employee cost and the plan with the highest employee cost is not more than $100.

   b) Any other plan may be aggregated with the group of plans in (a) if such other plan is comparable under the general comparability range to the plan within the group with the largest employer-provided benefit.

   c) A plan may also be treated as comparable to the group of plans described with respect to an employee if:

      (i) in the case of a non-highly compensated employee, such employee is eligible under the plan within the group with the largest employer-provided benefit;

      (ii) in the case of a non-highly compensated employee, the employee contribution permitted with respect to the group of plans under the general safe harbor; and,

      (iii) the employer-provided benefit under the plan outside the group is less than the employer-provide benefit under the plan within the group with the largest such benefit (without taking into account any plans aggregated under (b) above).

CHAPTER V

FAMILY COVERAGE, COVERAGE ELSEWHERE AND SWORN STATEMENTS

INTRODUCTION

For purposes of determining whether health plans providing coverage to the spouse and dependents (if any) of an employee (i.e., family-only coverage) satisfy the requirements of the 90-percent/50-percent eligibility test, an employer may elect in writing to apply special rules.

An employee who is eligible to receive family-only coverage under a health plan or would be eligible under the same terms and conditions as other eligible employees if the employee had a spouse and dependents may be treated as eligible to receive such family-only coverage without regard to whether the employee has a spouse and dependents. This is the case without regard to whether there is a requirement of an employee contribution or other employee election under the plan so long as any such election is uniformly available. If the employer applies this rule with regard to any employee or any health plan, the employer must apply the rule uniformly with regard to all employees and health plans except to the extent such application would cause a plan to fail the non-discriminatory provisions test.

In the case of the 75-percent benefits test and 80-percent coverage test, an employer may elect in writing to apply the requirements of those tests for a testing year by testing its health plan or plans that provide employee-only coverage separately from the health plan or plans that provide family-only coverage. If the employer tests family-only coverage separately from employee-only coverage, all family-only coverage must be tested together. Therefore, an employer may not separately test coverage provided to a spouse from coverage provided to a dependent. Separate testing may be elected without regard to the fact that family-only coverage is not available as a separate option to employees (i.e., the employee-only and family-only coverages are available or provided only as a package to the employee). No amendment to a written plan document is required to test separately.

Further, in applying the 75-percent benefits test or the 80-percent coverage test for a testing year to a health plan that provides family-only coverage, an employee does not fail to be treated as receiving family-only coverage merely because the employee does not have a spouse or dependents. This is the case without regard to whether the employer has elected separate testing. Thus, for example, if an employer automatically provides an employee with family-only coverage (i.e., such coverage is provided on a non-elective, non-contributory basis) or automatically provides an employee with family-only coverage if the employee purchases employee-only coverage and the employee does purchase such employee-only coverage, the employee may be treated as having received the family-only coverage even though the employee does not have a spouse or dependents.

If an employer does not elect to test plans providing employee-only coverage separately from plans that provide family-only coverage, an employee who has a family may be disregarded for purposes of applying the requirements of the 75-percent benefits or

80-percent coverage test if either of the following two requirements are met. First, such employee and family members (if any) all receive core health coverage from another employer or from the spouse's or a dependent's employer. Second, if the employer does not provide a health plan that includes employer-provided, family-only coverage, then the employee must receive core health coverage from another employer or from the spouse's or a dependent's employer.

If an employer elects to test employee-only coverage separately from family-only coverage, an employee may be disregarded for purposes of applying the requirements for the two tests with respect to the family-only coverage if such employee does not have a family or if such employee has a family and the family members all receive core health coverage from another employer or from the spouse's or a dependent's employer. Similarly, with respect to the employee-only coverage, an employee may be disregarded if the employee receives core health coverage from another employer or from a spouse's or a dependent's employer. In testing only the health plan or plans that provide employee-only coverage, employees are taken into account without regard to whether they have families.

SWORN STATEMENTS

An employer may not elect the above rules unless the employer obtains and maintains adequate sworn statements. In the absence of an adequate sworn statement with respect to an employee, the law requires the employer to act in accordance with certain presumptions (see regulations).

An adequate sworn statement must contain sufficient information to indicate whether the employee has a spouse or any dependents and, if so, the number of dependents. The statement must indicate core health coverage received under a plan of another employer or the employer of the spouse or dependent. An employer cannot rely on sworn statements for testing years beginning after 1989 unless such statements are made under penalty of perjury and contain a designation of the employer-provided health coverage currently received by the employee under the employer's health plan or plans. In lieu of including information about the employer-provided health coverage being received by an employee under the employer's health plans, an employer may use any other reasonable method to enable it to determine, for each testing year, the extent to which an employee who is receiving core health coverage under a plan of another employer is also receiving employer-provided health coverage from the employer. A sworn statement is not required to be notarized or on a form approved in advance by the Commissioner of the IRS.

If an employee is eligible to receive employee-only coverage under a core health plan of the employer with a substantial employer-provided benefit at no cost to the employee and such employee does not elect to receive it, the employer may treat such employee as having completed an adequate sworn statement that the employee has core health coverage from another employer. The same is true when an employee is eligible to receive family-only coverage under a core health plan of the employer with a substantial employer-provided benefit and at no cost, and such employee does not elect to receive it. Even if a sworn statement is deemed to have been completed, the employer must establish by other reasonable methods the extent to which employees receive health coverage from such employer. The plan has a cost to the employee if the employee is required to make any after-tax or salary reduction contributions or to waive any other benefit (taxable or otherwise) in order to obtain the health coverage.

An employer that elects to use sworn statements must obtain such statements on no less frequent a basis than once each three consecutive years. If the employer does not obtain sworn statements from substantially all of its employees or from a statistically valid random sample of all of its employees determined under certain statistical standards (see Chapter VI),the employer must obtain such sworn statements on an annual basis.

A highly compensated employee cannot be disregarded, for these purposes, if such employee receives an employer-provided benefit under all health plans of the employer that is greater than 133-1/3 percent of the average employer-provided benefit under all such health plans received by non-highly compensated employees. This rule is applied separately with respect to employee-only coverage and family-only coverage if the employer elects to test such coverages separately.

A non-highly compensated employee may not be disregarded because of other core health coverage unless, at the time such other coverage ceases, such employee is eligible to elect coverage under any core health plan of the employer for which the employee was eligible (through election or otherwise) during the immediately preceding period in which the employee could have elected coverage (e.g. an open season). The election period for purposes of the rule must be no shorter than 30 days. This rule applies without regard to the reason for the cessation of the employee's other core health coverage and without regard to whether the employer's health plans otherwise permit employees to commence coverage at other than an open season.

Similarly, a non-highly compensated employee may not be disregarded as having no family or having a family with other coverage unless such employee is eligible to elect family-only coverage, upon a change in family status in which the employee acquires a family or upon a loss of such other coverage for a member of the family. This does not require that an employee be eligible to participate under a plan for which the employee would not previously have been eligible.

In addition, any otherwise applicable eligibility conditions that would have barred participation during the immediately preceding open season, such as insurability, may continue to be applied with respect to eligibility, but only if such conditions exist at the time the other core health coverage ceases and such conditions are applied on a uniform, consistent and non-discriminatory basis. However, in no event may an employer impose conditions on eligibility that were not previously applicable to such employee during the immediately preceding open season. Conditions that were previously applicable may be applied with regard to the facts in existence either at the time of previous eligibility or at the time the other core coverage ceases, as long as such application is on a uniform, consistent and non-discriminatory basis. This rule is applicable only for plan years beginning after December 31, 1990.

NON-CORE BENEFITS

The term core health benefits generally refers to coverage providing comprehensive major medical and hospitalization benefits and similar types of health benefits. The following are **NOT** core benefits:

[redacted]

CHAPTER VI
COMPLIANCE

TESTING YEAR

An employer must designate a uniform, 12-month testing period for all its plans of the same type. It may or may not coincide with the plan year. If the employer does not designate a testing year, then the testing year is the calendar year.

In certain circumstances, an employer may elect a short testing year. To the extent that the employer elects to test plans of different types together for purposes of certain non-discrimination tests, all these plans must be tested on a uniform testing year. Thus, if an employer tests its group-term life insurance plans with its dependent care assistance programs for purposes of the 75-percent benefits test, all such plans and programs must be tested on the same 12-month period. The same rule applies when the employer aggregates its health plans with its group-term life insurance plans to enable its group-term life insurance plans to satisfy the requirements of the 75-percent benefits test.

The first testing year of an employer with respect to plans of the same type generally must begin on the first day of the first plan year that any plan of that type is subject to Section 89. Also, the employer may use an earlier testing year, including the calendar year, for 1989. Thus, for testing years beginning in 1989, the employer is required to test all its plans of the same type together even though not all of such plans are subject to the requirements of Section 89 for the entire testing year. An employer must test all benefits under the plans as if they were subject to Section 89 for the entire testing year. However, in determining any excess benefits under the plans, an employer may prorate the amount of any excess to reflect the extent to which coverage is subject to Section 89.

TESTING DATE

An employer may choose any date as the testing date; however, the date must be used consistently. If a testing date is not designated then it shall be the last day of the testing year.

CHANGES

Changes of the testing year or testing date can only be made with the consent of the IRS. Consistency is the key.

SAMPLING

Rather than demonstrate compliance based on data with respect to all employees, an employer may use a sample. It must be a statistically valid sample. A sample is valid if the statistical method and sample size produce a 95-percent level of confidence that the sample results have a margin of error not greater than 3 percent. If the sample suggests the plans are discriminatory, complete data on the HCEs must be collected and the discrimination tests applied again. The sample can still be used for the NHCEs.

SPECIAL TRANSITION RULES

For 1989 and 1990, an employer may decide to adopt an alternative to the 75-percent benefits test for its health plans. Under this alternative, an employer must treat as includible in gross income (i.e., as discriminatory excess benefits) all employer-provided coverage under its health plans with respect to certain highly compensated employees. Also, if an employer adopts this alternative for 1989, the employer may use a modified version of the 90-percent/50-percent eligibility test under which at least 80 percent of the non-highly compensated employees must be eligible to participate in plans of the same type that, on an aggregate basis, are at least 66 percent as valuable as the aggregate value of the plans of the same type available to any highly compensated employee. For testing years ending in 1990, this modified version of the 90-percent/50-percent eligibility test is not available and the class of highly compensated employees who are considered to receive taxable employer-provided health coverage under the alternative to the 75-percent benefits test is broadened.

The IRS regulations provide a permanent alternative to the general non-discrimination tests for certain large employers whose employees are substantially all non-highly compensated employees. Under this alternative, an employer's health plans satisfy Section 89's non-discrimination tests if the employer employs at least 5,000 individuals; at least 90 percent of the full-time active employees are non-highly compensated employees; less than 0.75 percent of all active employees have compensation in excess of twice the Internal Revenue Code Section 414(q)(1)(C) amount ($50,000 indexed); at least 80 percent of those employees eligible to participate in each plan are non-highly compensated employees and 80 percent of the non-highly compensated employees have available to them under all health plans a health benefit that is at least 80 percent as valuable as the largest such benefit available to any highly compensated employee; and, at least 66 percent of all non-highly compensated employees receive core health benefits that are at least 66 percent as valuable as the largest such benefit available to any highly compensated employee. In addition, the non-discriminatory provisions test must be satisfied. This alternative is only available to determine if any employer's health plan or plans are discriminatory; it is not available to determine the amount of excess benefits.

VALUATION

Valuation of the benefits and coverage are perhaps the most difficult element of the Section 89 process. Eventually the IRS is to establish a table prescribing the relative values of different types of health coverage.

The effective date of these rules, when published, will be either the first testing year beginning at least one year after issuance of the rules or the first testing year beginning after

December 31, 1990, whichever is later. In the interim, the value may be the value of the coverage for health and group life insurance.

For the purposes of the eligibility and benefit safe harbor tests, the employer may use any reasonable method to determine value.

Pursuant to the temporary special valuation rule, the value of an accident or health plan may, for purposes of determining if a plan is discriminatory, be calculated under any actuarially reasonable valuation method adopted by the employer. In addition, an employer may, under a reasonable valuation method, use the cost of accident or health coverage as the value of such coverage. In such cases, the cost is to be determined in the same manner that the employer determines the applicable premium for purposes of the health care continuation rules (required by Internal Revenue Code Section 4980B). Cost may be determined in advance based on estimates. This does not mean, however, that the entire cost of accident or health coverage is to be used as the value of the employer-provided benefit. It is only the employer's share of such cost that may be used as the value of the employer-provided benefit.

To facilitate planning, an employer may use, as the cost of accident or health coverage for a testing year, the average annual cost or substantially similar coverage provided during the immediately preceding one or two years.

The employer also may make reasonable adjustments to the cost of coverages to eliminate cost differences between the coverages attributable to (1) differences in the cost of accident or health coverage in different geographic areas, and (2) the demographic characteristics of the covered employees. For example, assume that the employer provides individual coverage to employees in State X that costs $1,000 per employee, but that would cost $1,200 per employee in State Y. Assume further that the employer also operates in State Y and tests its State X employees with its State Y employees under Section 89. In such case, the employer may, for example, treat the individual coverage provided in State X as costing $1,200 for purposes of testing such coverage with the coverage provided in State Y.

Another example of a permissible adjustment under the above rule would be an age-related adjustment. For example, assume that the employer provides individual coverage to a group of young employees that costs $800 per employee, but if provided to a group of the employer's older employees would cost $1,100. In such a case, the employer may treat the individual coverage provided to the young employees as costing $1,100 for purposes of testing such coverage with the coverage of the older employees.

The employer may also adjust its cost to eliminate differences in costs between coverages that are attributable to differences in utilization of certain health care features that are common to the different coverages. For example, if all of an employer's cancer cases arise under a specific health plan and the cancer-relevant health features of such plan are common to other health plans, the costs of such plans may be adjusted to eliminate this utilization distortion. This adjustment is to be made after the adjustments described above and is to be made by estimating the cost of all plans that are tested together and that have the common feature as if the utilization had been evenly distributed among the plans. If this adjustment is made with respect to one health care feature common to a group of plans, it must be made with respect to all features common to such group of plans.

If an employer does not use cost as its valuation method, a valuation method will not be considered unreasonable solely because it does not take into account every feature of every accident or health plan provided by the employer. It may be reasonable to disregard a very limited number of features that have little effect on value, but are burdensome to value precisely. However, if any feature has significant value or is made available to a highly disproportionate number of highly compensated employees, such feature may not be disregarded under a reasonable valuation method. An example of a feature that has significant value and typically is made available to a highly disproportionate number of highly compensated employees is an annual physical examination.

All of an employer's accident or health plans that are tested together under Section 89 are to be valued under the same actuarially reasonable valuation method. Thus, if an employer uses cost as its valuation method and adjusts cost under one or more of the rules described above, the employer must use cost and make the same adjustments to all plans tested together under Section 89.

This rule, requiring an employer to use the same valuation method for all of its plans, means that, for example, two health plans with identical costs (if cost is used), or coverages (if a non-cost valuation method is used), may not be assigned different values merely because one is a health maintenance organization and one is an indemnity plan.

Similarly, the same valuation method should be used for valuing, for example, dental plans, hearing care plans, vision plans, physical examination plans, substance abuse programs, etc.

In order to determine if accident and health coverages are discriminatory, two steps are necessary. First, the total value of all accident and health coverage must be determined. The second step is determining the portions of such coverage that are employer-provided. This determination is to be based on the actual cost of the coverage, determined in the same manner that the employer determines the applicable premium for purposes of the health care continuation rules. Cost may be adjusted for this purpose for differences in utilization in the manner described above. However, none of the other adjustments described above is permitted.

Assume that the actual cost of health coverage provided to an employee is $1,600 and the employee contributes $400 of this amount. The employer-provided health coverage is 75 percent of the total coverage received by the employee. If the employer uses the same actual cost for testing purposes, the employer-provided coverage will have a value of $1,200, rather than $1,600, the employer-provided portion for testing purposes is 75 percent of $1,200 or $900.

CHAPTER VII

LINE OF BUSINESS, MULTI-EMPLOYER PLANS, CAFETERIA STYLE PLANS

LINE OF BUSINESS

An employer may apply Section 89 rules to each separate line of business or operating unit.

A bona fide line of business or operating unit will not be treated as separate unless:

1) **the line of business has at least 50 employees;**
2) **the employer notifies the IRS; and,**
3) **the highly compensated employee percentage with respect to such line of business is:**
    - (i) **not less than one-half, and**
    - (ii) **not more than twice the percentage which highly compensated employees are of all employees of the employer. An employer shall be treated as meeting the requirements of clause (i) if at least 10 percent of all highly compensated employees of the employer perform services solely for such line of business.**

These requirements shall be treated as met with respect to any line of business if such requirements were met with respect to such line of business for the preceding year and if:

- (i) **no more than a de minimis number of employees was shifted to or from the line of business after the close of the preceding year, or**
- (ii) **the employees shifted to or from the line of business after the close of the preceding year contained a substantially proportional number of highly compensated employees.**

Separate operating units must be at least 35 miles apart. A line of business or operating unit includes all employees necessary for the preparation of property for sale to customers or for the provision of services to customers. Thus, a headquarters or home office is not to be treated as a separate line of business or operating unit. Certain exceptions to the general rule (but not to its application to headquarters or home offices) may be established by regulation where an employer has two operations that are vertically integrated and that traditionally are operated by unrelated entities.

In addition, whether claimed lines of business or operating units are separate and bona fide is a facts-and-circumstances determination requiring examination of each particular situation. Differences and similarities between the services provided and products produced by such claimed lines of business or operating units are, of course, important considerations. Also, the manner in which the employer organizes itself is relevant. Thus, if an employer fails to treat itself as comprised of separate lines of business or operating units in an equivalent fashion for certain purposes, such as for coverage under an employer-wide qualified plan, it may not be appropriate to allow such activities to be treated as separate lines of business or operating units.

Notwithstanding the general rules described above, the line of business or operating unit concept is not to be used to undermine the non-discrimination rules. Thus, for example, certain job classifications (such as hourly employees or leased employees) are not to be treated as in a line of business or operating unit. Also, for example, secretaries and other support service personnel are not to be treated as in a line of business or operating unit separate from the lawyers, other professionals, or other employees for whom such personnel perform services. Likewise, nurses and laboratory personnel are not to be treated as in a line of business or operating unit separate from the medical doctors for whom they perform services.

MULTI-EMPLOYER PLANS

Section 89 addresses the subject of multi-employer plans with a series of special rules and exceptions. An employer using a multi-employer plan should consult with an expert.

Examples of the special rules include:

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1) **An employer contributing to a multi-employer plan is entitled to use a special method for determining excludible employees only if that employer does not contribute to the plan on behalf of an employee who performs professional services. Thus, the determination of eligibility for the special method is applied on a contributing employer-by-contributing employer basis. For purposes of this provision, professional services include the following services: legal, medical, engineering, architecture, actuarial science, financial, consulting, accounting, and such other services as the Secretary of Treasury shall determine.**

2) **An employer may treat the contribution such employer makes to a multi-employer plan on behalf of an employee as the employer-provided benefit of such employee under such plan if:**

(i) **The allocation of plan benefits between highly compensated employees and other employees under a multi-employer plan (or within either of such groups) varies materially from the allocation of employer contributions to such plan, or the employer contributions relate to benefits of different types.**

(ii) **This does not apply to any employer maintaining a multi-employer plan if such employer makes contributions to such plan on behalf of any individual performing services in the field of health, law, engineering, architecture, accounting, actuarial science, financial services, or consulting.**

3) **The IRS will allocate the reporting responsibility with respect to plans between the individual employers and multi-employer plan based on the agreement between the parties.**

CAFETERIA STYLE PLANS

For most purposes of Section 89, cafeteria plans (basically, an employee chooses benefits from a "menu" of options) are tested the same as any other plan. For the purposes of satisfying the 90/50 test and the proportionate reduction for part-time employees, benefits paid for by a salary reduction agreement are treated as provided by the employee, not the employer.

CAUTION: The IRS regulations include specific rules regarding salary reduction programs.

Elective contributions under a plan may be taken into account in satisfying the 90/50 test if:

The percentage of non-highly compensated employees eligible under the plan is not greater than the same percentage of highly compensated employees;

All eligible employees are eligible under the same terms and conditions;

No eligible highly compensated employee is also eligible for any benefit of the same type that is not equally available to every eligible non-highly compensated employee; and

All salary reduction amounts are taken into account with respect to any employee.

Employers who maintain cafeteria plans may limit the elections made by highly compensated employees in a non-discretionary manner. An employer is prohibited from applying the limitations on elective contributions based on utilization of elective amounts or based on any other system that has the effect of avoiding the cafeteria plan rule that elective contributions not used during a year are forfeited.

For purposes of applying the cafeteria plan non-discrimination rules, an employer may exclude a category of employees from consideration only if all employees in such category are excluded with respect to all options offered by the cafeteria plan.

In the case of a cafeteria plan that fails the cafeteria plan non-discrimination test, only highly compensated employees are required to include the available taxable benefits in income. In the case of a cafeteria plan that fails the employee concentration test, only key employees are required to include the available taxable benefits in income.

The qualified cafeteria benefits include benefits that would be qualified benefits but for the fact that they are includible in an employee's income because of a failure to satisfy the non-discrimination requirements. Thus, if, for example, there is a discriminatory excess with respect to a health plan offered under a cafeteria plan, such discriminatory excess will not cause the cafeteria plan to cease to be a cafeteria plan.

CHAPTER VIII

SANCTIONS

QUALIFICATION REQUIREMENTS

If an employer fails to comply with the qualification requirements for any benefit whether statutory or other as outlined in Chapter II then:

> **The benefit must be included in the gross income of any employee that receives the benefit;**
>
> **The amount includible is the value of the *benefits* not the coverage attributable to contributions made by the employer. In the case of statutory benefits failing the non-discrimination tests (*see Chapter IV*) income includible must be coordinated;**
>
> **The amount is includible in the taxable year in which benefits are received; and,**
>
> **The employer tax penalty is equal to the highest individual tax rate multiplied by the employee's employer-provided benefit.**

If a plan fails to satisfy the writing or notice requirements and such failure constitutes a de minimis failure, then the plan will be deemed to have complied, provided that such failure is corrected within 90 days after the employer has notice of such failure.

A de minimis failure exists only if: the employer acted in good faith and made a reasonable effort to comply with the applicable requirement; the failure did not have the effect of causing the plan to discriminate in favor of one or more highly compensated employees; and, correction of the failure cannot require that coverage be reduced under the single written document (as that plan existed at the time of the failure).

The amount of the employer-provided portion of the benefits to be included in income shall not exceed the sum of the following four amounts: 10 percent of the employee's compensation (before inclusion of the employer-provided benefit) from the employer maintaining the plan for the employee's taxable year, up to and including the dollar amount in effect for such year under Internal Revenue Code Section 414(q)(1)(C); 25 percent of the employee's compensation in excess of such dollar amount up to and including 200 percent of such dollar amount; 75 percent of the employee's compensation in excess of 200 percent of such dollar amount up to and including 300 percent of such dollar amount; and 100 percent of the employee's compensation in excess of 300 percent of such dollar amount. This limitation is applied after the determination of the employer-provided portion of the non-excludible benefits, but before the coordination of non-excludible benefits with excess benefits, resulting when plans fail the discrimination test.

STATUTORY BENEFITS

Discriminatory Excess

In the case of statutory benefits, if the plan is determined to be discriminatory in favor of HCEs, the discriminatory excess must be includible in the gross income of the employee.

Discriminatory excess is the amount of the otherwise non-taxable employer-provided benefit that the highly compensated individual would have had to purchase on his or her own so that all the non-discriminatory tests under Section 89 would have been met. Special rules apply for group-term life insurance.

A highly compensated employee's excess benefit under a discriminatory employee benefit plan is determined only under the failed tests. Thus, for example, if each health plan satisfies the 50-percent eligibility test, but the health plans collectively fail to satisfy the 75-percent benefits test, excess benefits are to be determined only under the 75-percent benefits test. However, an employer may elect in writing to use the 80-percent coverage test to determine excess benefits without regard to whether it used that test in determining compliance with Section 89 and vice versa.

When an employer's health plan of the same type fails to meet more than one requirement, the excess benefit calculations for the failed requirements are to be made in the following order: the 50-percent eligibility test; the 90-percent/50-percent eligibility test; and the 75-percent benefits test. If a highly compensated employee is determined to have an excess benefit under the 50-percent eligibility test, then for purposes of determining such employee's excess benefit (if any) under the 90-percent/50-percent eligibility test, such employee's employer-provided benefit for purposes of the 90-percent/50-percent eligibility test excess benefit calculations is first reduced by the amount of such employee's excess benefit determined under the 50-percent eligibility test excess benefit calculation. If a portion of the employer-provided benefit of the plan that failed the 50-percent eligibility test is attributable to salary reduction contributions, then the same portion of an employee's excess benefit with respect to such plan is treated as attributable to salary reduction contributions. For purposes of determining excess benefits under the 75-percent benefits test, a highly compensated employee's employer-provided benefit under the plan or plans that failed the 50-percent eligibility test or the 90-percent/50-percent eligibility test (or both) is first reduced by the amount of such employee's excess benefit with respect to such test or tests.

For purposes of making the excess benefit calculations, all highly compensated employees who receive employer-provided benefits for a testing year under a plan or plans that fail the applicable non-discrimination test are eligible to be treated as receiving excess benefits. This is the case even though such highly compensated employees were not taken into account for any reason on the testing day for such testing year. In addition, only employer-provided benefits that highly compensated employees actually receive for a testing year under a plan or plans that fail the applicable non-discrimination test may be treated as excess benefits. Thus, for example, a highly compensated employee does not have an excess benefit with respect to a plan that fails the 50-percent eligibility test merely because such employee is eligible to receive, but does not actually receive, employer-provided benefits (e.g., health plan coverage) under such plan. Similarly, employer-provided benefits that highly compensated employees do not actually receive but were treated as having received under the rules providing for the annualization and adjustment of the employer-provided benefits for the testing day are not treated as excess benefits.

In the case of the first testing year beginning in 1989 of an employer that is using the transition rule, the excess benefits (if any) for such testing year may be determined by reference to those employer-provided benefits that highly compensated employees actually receive for the partial testing year, annualized for the entire testing year. If an employer makes such an election, the employer must provide those highly compensated employees having excess benefits an opportunity to demonstrate that they actually received less employer-provided benefits during the portion of the testing year preceding the partial testing year than the deemed employer-provided benefits. If an employee makes such a demonstration, the employer must recalculate such employee's excess benefit based on the employer-provided benefits actually received for the entire testing year and make any amendments to required reports relating to such employee (e.g., Form W-2).

A highly compensated employee's excess benefit under a health plan that fails to satisfy the 50-percent eligibility test is equal to that portion of the employer-provided benefit actually received by such employee under the plan that is in excess of the maximum employer-provided benefit that such plan may have and be included in a group of comparable plans that satisfies the 50-percent eligibility test.

A highly compensated employee's excess benefit under plans of the same type that fail to satisfy the 90-percent/50-percent eligibility test is equal to that portion of the employer-provided benefit actually received by such employee under such plans that is in excess of 200 percent of the largest amount of employer-provided benefit available to at least 90 percent of the employer's non-highly compensated employees. For this purpose, benefits attributable to salary reduction contributions by non-highly compensated employees are not treated as employer-provided benefits. In addition, benefits with respect to highly compensated employees that are attributable to salary reduction contributions are not treated as employer-provided benefits except to the extent that such contributions are treated as employer contributions.

A highly compensated employee's excess benefit under plans of the same type that fail to satisfy the 75-percent benefits test is determined under specific rules. If plans of different types are tested together, then such plans are treated as plans of the same type for purposes of these rules.

The 75-percent benefits test is to be reapplied for the testing year with respect to those plans of the same type by taking into account all highly compensated employees of the employer and the employer-provided benefits that such employees actually received for the testing year. If upon such reapplication of the 75-percent benefits test, such test is satisfied, there are no excess benefits under Section 89 with respect to such test.

Excess benefits under the 75-percent benefits test are determined by reducing the employer-provided benefit of the highly compensated employee or employees with the highest amount of employer-provided benefit for the testing year, under the 75-percent benefits test as reapplied, until either such employee's employer-provided benefit is equal to the next highest amount of employer-provided benefit for any highly compensated employee or if no such "next-highest" employee exists, until the employee no longer has any employer-provided benefit. This method of reduction is then applied with respect to additional highly compensated employees (beginning with highly compensated employees with the highest remaining amounts of employer-provided benefits) until the 75-percent benefits test is satisfied. A highly compensated employee's excess benefit is equal to the total amount of such employee's employer-provided benefit that is reduced under these rules.

A highly compensated employee 's excess benefit under a plan that fails to satisfy the 80-percent coverage test is equal to that portion of the employer-provided benefit received by such employee under the plan that is in excess of the maximum employer-provided benefit that such plan may have and be included in a group of comparable plans.

Determination Example

Assume that an employer uses the calendar year as its testing year and January 1 as its testing date. Assume further that all of the employer's accident and health plans satisfy the 50-percent test, the 90-percent, and the non-discriminatory provision test. Assume that the employer elects to test employee coverage and coverage of spouses and dependents together for purposes of the 75-percent test.

Assume that for 1990, the following facts exist:

DETERMINATION OF DISCRIMINATORY EXCESS

Employee	Employment during 1990	Employer provided benefit	Testing value
A	1/1-6/30	$ 500	$1,000
B	1/1-12/31	1,000	1,000
C	1/1-12/31	1,500	1,500
D	2/1-12/31	1,375	N/A
E (highly compensated)	1/1-6/30	900	1,800
F (highly compensated)	1/1-12/31	1,800	1,800
G (highly compensated)	2/1-12/31	917	N/A

Assume further that there are no changes in plan design or changes in highly compensated employees' elections during 1990.

The employer-provided benefit column provides the actual employer-provided benefits received by each employee during 1990. The testing value column provides the annual value of the employer-provided benefit that each employee receives on the testing date. This testing value is determined by taking into account the actual employer-provided benefit for each employee who is employed on the testing date, but adjusting such benefit to the value of the benefit as if it were provided for the entire testing year. It is this value that is used for purposes of applying the 75-percent test. There are no testing values for D and G because they are not employed on the testing date and thus are disregarded for testing purposes.

Based on these facts, for purposes of the 75-percent benefits test, the average employer-provided benefit for the non-highly compensated employees is $1,167 [($1,000 +$1,000+$1,500)/3]. The average employer-provided benefit for the highly compensated employees is $1,800 [($1,800 +$1,800) / 2]. In order to satisfy the 75-percent test, the average employer-provided benefit may not exceed $1,556 ($1,167 / .75). Thus, there is a discriminatory excess under the 75-percent test.

Once an employer determines that there is a discriminatory excess under the plan, the employer is required to determine the actual employer-provided benefit for every highly compensated employee, including those not employed on the testing date, and apply the tests based on such data. This calculation may result in an increase or decrease or even an elimination of the discriminatory excess. The average employer-provided benefit for non-highly compensated employees is not recalculated.

For example, under the above facts, the average employer-provided benefit for the highly compensated employees is $1,497. This is determined under the present-law rules applicable for purposes of the 75-percent test (i.e., by including the actual employer-provided benefit in the numerator and counting an employee as less than a full employee in the denominator if such employee is not employed for the entire year). In this example, E is 1/2 of an employee and G is 11/12 of an employee. Thus, the average employer-provided benefit for the highly compensated employees is calculated as follows: ($900 + $1,800 + $917) / (1 + 1/2 + 11/12) = $1,497. Because $1,497 is less than $1,556, there is no discriminatory excess under the 75-percent test.

Assume, however, that G's actual employer-provided benefit is $1,650, rather than $917. In this case, the average employer-provided benefit (based on actual data) for the highly compensated employees is $1,800. This amount is calculated as follows: ($900 + $1,800 + $1,650) / (1 + 1/2 + 11/12) = $1,800. Because $1,800 is above the maximum permitted average for the highly compensated employees of $1,556, there is a discriminatory excess, and it is necessary to allocate the excess among the highly compensated employees.

The amount of the discriminatory excess is determined and allocated as follows. First, the total discriminatory excess for all highly compensated employees is determined by (1) calculating what the total employer-provided benefit for all highly compensated employees would be if the average employer-provided benefit for such employees satisfying the benefits test, and then (2) subtracting the amount in (1) from the total actual employer-provided benefit for all highly compensated employees.

In the example, the calculation of the total permitted employer-provided benefit for highly compensated employees is $1,556 x (1 + 1/2 + 11/12) = $3,760. Then this amount is subtracted from the actual employer-provided benefit for the highly compensated employees to obtain the total excess of $590 as follows: ($900 + $1,800 + $1,600) - $3,760 = $590.

To allocate the $590 of discriminatory excess among the highly compensated employees, F's benefit is reduced first, because F has the highest employer-provided benefit. Thus, F's otherwise nontaxable, employer-provided benefit is reduced by $150, to the level of G's employer-provided benefit. Then, F's and G's benefits are reduced equally until the remaining $440 of excess ($590 - $150) is allocated. That is F's benefit is reduced by an additional $220. Thus, F's total nontaxable benefit is $1,430 ($1,800 - $150 - $220), as is G's ($1,650 - $220). A total of $370 ($150 + $220) is includible in F's income, and a total of $220 is includible in G's income.

The benefit is includible in income in the employee's taxable year in which, or with which, the plan year ends, but if the testing year ends after September 30, and on or before December 31, an employer can elect to include it in the employee's next taxable year but the employer must take the deduction for that amount in its taxable year that follows the taxable year in which the testing year ended.

Employer Sanction

The employer must pay a penalty tax for failure to report the excess equal to the product of the highest individual tax rate times the portion of the employee's benefit that bears the same relationship to the total benefit as the unreported amount bears to the entire amount that should have been reported.

Senator **Boschwitz**. Thanks, Valerie. What do you manufacture, windows or trusses?

Ms. **Hansen**. Lots of trusses and architectural woodwork.

Senator **Boschwitz**. All right, that was very helpful.

I would ask is there any representative of the Treasury still here?

I would ask the staff to be sure that the Treasury, Mr. Trier is aware of the testimony that succeeded his, that you, the minority and majority staff, go to him and present him with the testimony of Ms. Hansen and the other testimony that we have already heard and we will wait until you get those letters. We will wait a week, let us say, so that we can add to the evidence. And if you would go through it with him so that he understands and he sees these letters and the other testimony so that our witnesses are not just preaching to the converted, so to speak.

I see that Mr. Lagos is here from Springfield, OH, and if you would proceed, Mr. Lagos. Your testimony is rather extended on behalf of the National Small Business United, and if you would be kind enough to summarize it.

All of the remaining witnesses, we would ask you to stay, Mr. Stigen, if you would like, and the other witnesses if you would come up and sit around the table, I would appreciate it.

STATEMENT OF JAMES H. LAGOS, ON BEHALF OF NATIONAL SMALL BUSINESS UNITED, WASHINGTON, DC

Mr. **Lagos**. Thank you very much, Senator Boschwitz. I am Jim Lagos from Springfield, OH. I am a lawyer by training. My brother and I have a small law firm. We also own a variety of small businesses. We are in the construction business. Our family is in retail clothing, just got out of the nursing home business. We are into farming and commercial real estate development and a variety of different businesses.

It is my pleasure to be here for National Small Business United today. I am the immediate past president.

Senator **Boschwitz**. I would say before you leave, Mr. Stigen, why do you not stick around for a few minutes. And the other witnesses, stick around if you can.

Go ahead. Where is Springfield, OH?

Mr. **Lagos**. West Central Ohio, sir, about 70-some thousand people.

Basically what we do for a living as far as the law firm is concerned, we represent a number of small business employers and then we also for that matter represent a bunch of employees that periodically sue small businesses. So, we get some good perspective on it, some perspective on the whole thing by virtue of the fact that we are involved in various businesses ourselves.

I ask that my rather extensive testimony be made a part of the record. I will not read any part of it.

I do want to summarize a few points concerning Section 89. I regard it basically as sort of a poison-tipped arrow striking at the heart of small business health and life insurance programs. I think it is a system failure. I do not think it can be reformed. I think it has to be repealed.

I wish to express my thanks to you and to Senator Bumpers for having these hearings and special thanks to Senator Lott for sponsoring the repeal bill.

I would also like to thank Senator Pryor and Senator Domenici for their efforts to try to reform the Section 89. Those are good efforts that they are making. I still think that total repeal of Section 89 is nonetheless preferable.

If you were to try to figure out a way to wipe out a large portion of the small business health and life insurance programs and other welfare programs small businesses have for their employees in this country, the best way to do it would be to deregulate those programs, No. 1, and, No. 2, to tax those programs, and that is exactly what Section 89 is trying to do.

And if you really wanted to wipe them out when you regulate them, you have to try to create as much paperwork as possible. You have to make the regulations as complicated as possible. You would have to make them non-productive so that the employer who is spending all of his time would basically come to the conclusion that what he is doing is a waste of his time and not really productive at all. And you would have to make the regulations uncertain.

On the tax front, if you wanted to wipe out all of these programs, what you should do is see to it that there is a provision that would make these plans non-deductible for the employer.

Worse yet, try to impose penalties on the employer who is trying in good faith to comply. Worse yet, impose penalties on the employees and taxes on the employees and penalties on the employees who have nothing to do with setting up the plans in the first place and basically ambush the entire group by having a situation where most of the employers are not aware and the employees are not aware of exactly what Section 89 does.

And finally, basically imposing a tax on the whole matter, and I would regard Section 89, Senator, as being something of a duck in that I do regard it as a tax. It is, in fact, a tax as well as a regulation.

In setting up this regulatory system and in setting up this tax system, I think what has been inadvertently done is to create a tremendous disincentive to every employer from having this type of a program of health and life insurance.

I will be honest with you. My brother and I in our business just canceled two health insurance programs that we had in existence for separate businesses. I think—and I am called upon to represent a lot of small businesses—as to whether or not their plans are in compliance.

I have read this many times and I do not think I am a total idiot, but I have very great difficult in understanding Section 89, and I, as a lawyer, fear a malpractice suit if I tell anybody that their plan is in compliance.

The easiest thing for me to do and what I have been doing, frankly, for a lot of clients is telling people if you have a small business health insurance program, you are a fool. There is no way in the world you are going to know if you are in compliance.

And basically our organization with some 50,000 members in National Small Business United consists of people and businesses who primarily have health insurance programs. We took a survey of our membership, sent out 16,000 questionnaires, got 1,800 of them back, and 91 percent of the people responding said that they had health insurance programs, and that was a substantial increase in 1988 from 1987.

And I submit to you that basically the situation we have here is that there will be a decrease in the number of our members who have health insurance programs next year unless we succeed in doing something concerning this particular problem.

When we testified last January in front of Congressman La Falce's House Small Business Committee, one of the things we pointed out as an example of how bad Section 89 is Section 89K.

At the time we told the Members of that Committee that is Section 89K is permitted, the latter part of the statute is permitted to continue in existence, that is you had a health insurance claim and some employee had $100,000 in health insurance payments—let us say he had a heart attack and had $100,000—that basically if the employer did not comply with Section 89K and get that information out and did not put the premiums of that particular employee on the W2 form of the employee, then that employee with $100,000 in bills would, in fact, get taxed as ordinary income of $100,000.

After we testified and we got a substantial amount of press on that particular issue, there was a letter sent out by Congressman Rostenkowski immediately saying that we are exaggerating the problem and that, in fact, would not happen and that the regulations coming out from the Internal Revenue Service would, in fact, correct the problem.

I have waited anxiously for the regulations of the Internal Revenue Service, and they basically confirmed our worst suspicions. On page 9 section 3 of the Internal Revenue regulations—and I am glad we have someone here from the IRS today—it stated that the term "benefit" when it is used at the tail end of Section 89, which is Section 89K, has a different meaning than the word in the beginning part of that section.

So, you have got one section of the Internal Revenue Code with definitions of the same word which are different. Benefits as far as Section 89K is concerned is the value of the benefits. In other words, not just the premium value, but the value of the benefits whether it is health insurance and the bills are paid, life insurance and somebody is trying to get the face value of the life insurance policy, or what have you.

Basically the small business that does not comply with Section 89K ambushes both the business and the employees to a hideous extent. This is further confirmed in the regulations on page 12 where it again states that the proposed regulation has intended to interpret Section 89K, in particular Section K3 as saying that the value of the employer-provided services are what is, in fact, provided.

So, what we have is a situation where many people when we first started the discussion of Section 89 said that the Internal Revenue Service would correct some of these problems and we would be able to deal with those. In fact, we have a confirmation by the Internal Revenue Service regulations that these are, in fact, problems.

What we have with small businesses is a very unlevel playing field. Small businesses who are proprietors who are sole proprietors and partners cannot deduct the health insurance premiums above a level of 25 percent. So, at the present time we have discrimination in existence which is actually discrimination caused by the Internal Revenue Code.

I submit to you that what we have to do first of all is eliminate the discrimination against small businesses already in existence in the Internal Revenue Code before we get into this situation where we attempt to impose upon those businesses more regulations that are now likely going to cause more and more businesses to eliminate their plans.

In essence what we are saying is we have to repeal Section 89. I again do thank Senator Pryor and Senator Domenici for some of their proposed reforms. I dealt with those rather extensively in my written testimony.

I do not think those reforms are going to go far enough. I think what we have here is a minefield for small business. Section 89 is a minefield. If you step on a mine, you do not know where the mine is, and basically there is no way that this bill could be performed sufficiently in order to save it.

Once again, I want to thank you very much for your time here, Senator Boschwitz. I will leave it at that if you have any questions.

[The prepared statement of Mr. Lagos follows:]

NSBU
NATIONAL SMALL BUSINESS UNITED

"Serving America's small businesses since 1937"

Statement of
James H. Lagos

on behalf of
National Small Business United

Before the
Senate Committee on Small Business

Concerning
Section 89 of the
Internal Revenue Service Code

April 13, 1989

1155 15th Street N.W. Suite 710, Washington, DC 20005
Telephone: (202) 293-8830 Telecopier: (202) 872-8543

Mr. Chairman and Members of the Committee:

I wish to express my appreciation and the appreciation of the 50,000 small businesses represented by National Small Business United to you for holding these hearings. You are giving us the opportunity to testify as to the effects of one of the most ill-conceived and devastating tax laws to come out of Congress in recent years.

As you may well know, National Small Business United is the oldest association exclusively serving the small business community of our nation--for over 50 years now. NSBU has a membership of over 50,000 individual companies with members in each of the 50 states, as well as local, state, and regional organizations. NSBU is uniquely qualified to express the views of the small business person. We urge the swift and total repeal of Section 89 of the Internal Revenue Code.

Section 89 was first designed to address the "problem" of discrimination in employer-based fringe benefit plans. Its goal, stated since by its proponents, was to extend health and life insurance coverage under these plans to all employees (or, to more employees). Section 89 will result in accomplishing exactly the opposite; in fact, many benefits will likely be terminated.

NSBU has entered this debate as a proponent of greater access to health care. Health care must be extended to the millions of uninsured in this country. But, to accomplish this goal, Congess must work to enable small businesses of this country to extend their health care benefits to more employees. Restraint of the skyrocketing cost of health insurance and increased competition for small business health insurance are fundamental to accomplishing this objective.

As long as we fail to adequately address our federal budget deficit, we will find further incentives for health care simply unacceptable. However, tax incentives will work far more effectively than tax penalties.

Section 89 and its complexities and penalties will work adversely to the goal of extending coverage to more of the nation's uninsured. If the objective is to end discrimination in the delivery of benefits, Section 89 will simply eliminate the delivery of benefits in many small businesses. Section 89 will increase the ranks of the uninsured. National Small Business United wants no part of any blame for increasing the numbers of uninsured in America.

The problems with Section 89 are manifold. The bookkeeping requirements are extremely complex and burdensome. Indeed, if the Regulatory Flexibility Act applied to Congress, this bad legislation never would have become law. The employer's first step is to satisfy the qualifications rules. These rules demand that the employer's health and life insurance plans: 1) are in writing; 2) guarantee that employee's rights are legally enforceable; 3) notify employees of benefits available under the plan; and 4) must be intended to be permanent.

Once the qualification rules are deciphered and met, the employer is just beginning to comply. Before the employer can begin to test benefit plans for compliance, more data gathering is required; the employer must:

- Identify the company's total number of plans
- Determine each plan's value
- Identify the employees actually participating in each plan, and
- Determine whether employees are classified as highly compensated or non-highly compensated.

Even these steps are not as easy as they sound.

Section 89 defines a benefit "plan" very narrowly. Under Section 89, each separate provision or benefit is considered a plan, and varying levels of coverage within the same plan types are considered to be separate plans. For instance, if a business which offers a fairly simple and straight-forward plan having a base health plan, a dental plan, and an HMO option has a layered structure for these plans: employee only, employee and spouse, and family options, then the business is considered to have nine different plans. An example is a business in California which believed it had just five plans, only to discover that, for the purposes of Section 89, it actually had 17 plans. Each one of those plans must meet a whole battery of tests--ones just described and ones to follow--and valuations and determinations must be made with respect to each and every employee.

Now, Section 89 gets even more complex. Employers must take their gathered data and apply it to eligibility and discrimination tests. Depending upon plan complexity and availability, employers can use one of two tests; one is the somewhat less complicated 80 percent alternative test and the other is the four-step method. It consists of 1) the 75 percent benefits test, 2) the 90-50 percent availability test, 3) the 50 percent availability test, and 4) the nondiscriminatory provision. Suffice it to say these tests are rather intricate. Once employers have reached this point, once they have stated their benefits policy, determined the number of offered plans, figured the value of these plans on a per-employee basis, decided which employees do and do not qualify as highly compensated, and, based upon those determinations, run the discriminations test, they can then determine whether or not they comply with Section 89. If they comply, nothing changes in their lives; if they do not, they may face major financial consequences on top of the regulatory nightmare they have just spent so much time and money to conquer.

Anyone who believes that small businesses can plausibly meet these requirements, given their time, accounting staff, legal knowledge, and general resources, either has real contempt for this country's small businesses or very serious misunderstandings about how they function.

Nevertheless, the penalties on small businesses for not complying with Section 89 can be severe indeed. The language of the law leads one to understand that, if a business is found to be outside compliance with Section 89, all highly-compensated employees would be taxed upon the "excess value" of their benefits. The law does not say "premiums;" it says "benefits," thus implying that the employee has tax liability for all excess benefits actually received. To cover these tax losses, the employee may bring suit against the employer. Worse, if the business believed itself to be in compliance and, thus, failed to record the excess value of the employee's benefits on the W-2 form, the employer also would be forced to pay steep fines for this error in addition to the tax losses of the employee. In any event, the employer loses its tax deduction for all health insurance premiums paid.

Most small enterprises will be forced to bring in outside consultants to evaluate their insurance plans and determine whether those plans comply with Section 89. The costs of these consultations usually run at least several thousand dollars per test--even for small businesses with simple plans. Once this evaluation is completed, there is another charge for coming into compliance and the high cost of changing and up-grading plans to meet the government requirements.

Section 89 creates a tremendous disincentive for employers to maintain health and life insurance programs for their employees. Small business owners will call upon attorneys, accountants, and benefits specialists to pass judgment on whether their benefits plans comply with Section 89. Section 89 is very complex, and those consultants could face huge liability if they tell a business that it is in compliance, only to have the IRS rule otherwise. The safest thing for those consultants to do is to tell those employers that it would be best for them to terminate their health and life insurance plans, give their employees a bonus, and simply tell them to buy these plans on their own.

Very often, employers will recognize this scenario and preemptively terminate their plans, thereby cutting out the cost of consultation, data collection, and compliance. Section 89 contains every incentive for employers to end their health coverage. Terminated benefits is the logical extension of this very bad legislation.

Even if small employers had the accounting staffs to do the data collection and if the benefits consultants were to interpret that data for free, it may be financially impossible for small businesses to comply with Section 89. What many do not realize is that health care premiums for small businesses run 30-40 percent higher than for big corporations. Small businesses do not have the number of employees to create large risk-pools to lower these costs. In too many cases, small businesses do not have the resources to provide equal, quality, health benefits to all of their employees. As health care costs continue to sky-rocket, this situation looks to be getting worse, not better.

Along comes Section 89, looking to impose a certain level of coverage without giving small businesses the resources to comply. Already, many non-incorporated small businesses are only able to deduct 25 percent of their health care costs. In too many instances, the only health care provided by many small businesses is that which is necessary to keep certain key people on board. They provide no more, not because they are heartless ogres, but because they simply do not have the money. Too often, small businesses lose out to big business in recruiting top employees because they do not have the resources to provide the benefits necessary to attract those people. Small businesses want to provide these benefits; it is in their best interest to do so. Many simply cannot. Section 89 does not solve their problem.

To solve the problem of inadequate small business access to health care, we must create a level playing field on which health care is accessible for small business as it is for big business. We must increase the deductibility of health costs to 100 percent for non-incorporated entities; further, we must make allow small businesses to combine or pool their employees in order to purchase insurance at more reasonable rates. We must give small businesses the necessary incentives to broaden their health care coverage; threatening to impose more economic sanctions--to effectively tax benefits--is no answer. Section 89 is backwards in its approach and counterproductive in its results.

Section 89 also imposes enormous costs on businesses who are, somehow, already in compliance with Section 89. Even if a business is not discriminating in its benefits practices, it must nonetheless go through the same data collection problems, hire the same army of attorneys, accountants, and consultants, and spend thousands of dollars; all in order to put a document on file that may be needed in years hence to prove compliance with Section 89 to the IRS. The cost to each individual small business with a health insurance program to qualify under Section 89 to make sure they are not getting into serious trouble will be exceedingly high. Even a two-man shop will have to go through the formalities of a written plan in order to comply with Section 89. The same rules will be applied for small businesses as are applied to large businesses. This will be, as a CPA told me, "awfully tough on small business."

If Section 89 was designed to end the practice of giving owners and executive fat-cats huge benefit plans while dropping crumbs to the employees, it was designed to end a problem more perceived than real. I will not pretend to suggest the problem has never existed; it is simply outside the norm and not at all pervasive. For the government to create a Section 89 to so up-end the way business provides benefits to its employees and to throw small businesses into such chaos over health care plans--in order to end this rare gross discrimination--is utterly irresponsible.

Some have argued that Section 89 should not be repealed because of its impact on revenues. Some estimates have placed the revenues resulting from Section 89 to be nearly $1 billion per year. Raising revenue should not be an excuse to force employers to spend many times that amount attempting to comply with Section 89. Counting on this revenue is tantamount to admitting Section 89 to be a failure. Revenue can only be raised insofar as businesses do not comply. It may be in the interest of those who want to raise taxes to construct a Section 89 with which businesses cannot comply. Furthermore, if Section 89 is to be viewed as a revenue raiser, then it must also be viewed as a back-door tax on benefits--and should be treated as such. Any increase in revenues should be applied directly to compensate those who are already uninsured or who become uninsured as a result of Section 89.

National Small Business United has concluded that full repeal of Section 89 is the only real and viable answer to the problems that have just been described. There has been found no acceptable alternative. There are serious problems with every part of Section 89. More than that, the very premise of Section 89 is flawed. If the designers of Section 89 believed that it would increase the availability of health care, small businesses are not in a position to respond to Section 89 in a way the supporters of this legislation must have guessed they would. The world of small business is not a bastion of deep pockets, always able to pay more and more, so long as the government requires it. If Congress wants small businesses to expand its health care benefits, they must enable small businesses to do so, not punish them for not doing so.

In the Senate, bills have been proposed to reform Section 89. NSBU sincerely thanks the Senators who have sponsored this legislation for taking an active interest in this issue and for working in good faith to try and work out a solution. Their time and effort are very much appreciated. I must clearly say, however, that these reforms simply do not go far enough. They have successfully initiated discussion on the complexities and conflicts imposed by Section 89, but this first draft of reforms must go further. They do not address the fundamental problems the small business community has with Section 89. Let me take a moment to comment specifically upon S.654.

This bill first proposes the establishment of a simplified health arrangement (that is, a "safe harbor" under which compliance would be greatly simplified). Under this plan, employers do not have to perform the non-discrimination tests if their health plan (assuming there is only one) is available to at least 90 percent of their employees. Also, this proposal indirectly establishes a minimum standard of benefits by imposing $6.70 per week (five percent of the minimum wage) as the maximum employee contribution to a health plan and $13.40 per week as the maximum contribution for dependent coverage. These absolute dollar amounts are indexed to increases in the minimum wage. The problems with this approach are many:

- First, the dollar levels for employee participation are so low, it is doubtful that there are many (if any) employers who would qualify, unless they require no employee contribution to their health plans. I have already described how such a high rate of participation (90 percent) with no employee contributions would break the backs of small employers.
- Second, health care costs and insurance premiums are escalating at a rate far in excess of increases in the minimum wage. The minimum wage has not been increased

since 1981; in the meantime, health care costs have more than doubled. Therefore, tying increases in employee contribution to the minimum wage will essentially mean yearly declines in the rate at which employees will contribute.

- Third, the 90 percent eligibility requirement is too high and too rigid for small firms. Ninety percent of five employees is 4.5 employees. Does the bill require provision of health insurance to all five employees or to four employees (80 percent)?
- Finally, the bill fails to address the circumstance where, because of the health history of several employees, insurance premium costs are either prohibitively expensive or health insurance is unavailable for them. A small company would not even be able to offer benefits to employees who fall into this category. In such a small company, if more than 10 percent of the employees fall into this category, a business owner's rational response to this proposal would be to drop the plan.

The bill does make several changes which NSBU believes would be helpful. For instance, it raises the maximum number of hours for an employee to be considered part-time from 17.5 hours per week to a maximum of 25 hours per week.

S.654 also changes the focus of Section 89 from a participation-based test to a design-based test. The design-based test allows flexibility to both the employer and the employee. It allows the employee to choose to receive insurance through other means (spouse plan, own funding, etc.) without placing the employer outside compliance. A design-based test only requires that employers offer coverage, not that employees accept that particular coverage. Employees may often choose to a form of compensation more suited to their particular needs. Another advantage to the design-based plan is that it does not require the enormous data gathering task required by a participation-based plan--the objective of which is to show how many employees are actually covered.

Essentially, though, the safe-harbor created by S.654 is one which is meaningless, because most small employers simply will not be able to meet its standards. With the recent escalations in the cost of health care, small employers must ask for an employee contribution greater than five percent of whatever the minimum wage may be (whatever it is, it has nothing to do with the cost of health care and insurance). The changes proposed by S.654 may make it easier for some businesses to fill in the appropriate box, but it does not attack the essence of the problem. Many small businesses find compliance difficult because they do not have and cannot afford the required coverage. This is the real problem that superficial changes to Section 89, such as these, cannot even begin to address.

Mr. Chairman and members of the committee, I respectfully submit to you that if Section 89 is not immediately repealed, there will be a stampede of small businesses canceling their life and health insurance programs. Section 89 is an ambush waiting to happen. It is an ambush of innocent and well meaning small business owners and their employees who will be subjected to enormous penalties from a law they do not even know exists.

I thank the members of the committee for holding these hearings. You have provided a vital service to the small business community. I encourage you to work as hard as possible for the immediate repeal of Section 89 of the Internal Revenue Code. I pledge to you that we, the members of National Small Business United, will be fighting side by side with you in this important battle. Thank you all very much.

Senator **BOSCHWITZ**. Thank you. You shed a different light and a different view on this whole thing. And, again, we will see to it that the Internal Revenue Service, and the Treasury becomes aware of it.

Now, we turn to Mr. McGehee. You are representing the NFIB, and if you two would—your testimony is relatively short, but I would appreciate it if you would summarize. I will tell you what. The hearing is going a little longer than we anticipated. I am going to take a 2 or 3 minute recess just to see exactly what is happening to the rest of my schedule if I may and having called the hearing and being the Chairman of the hearing, I do not have the prerogatives that the others do of leaving, nor do I want to leave. So if you would excuse me we will take a very brief recess, and return within 2 minutes.

[Recess.]

Senator **BOSCHWITZ**. I am afraid I am going to have to ask the witnesses who have been so patient to compress their testimony because my schedule has plain got compressed. We will include the entirety of your testimony. You are from Arkansas. You have come a long way and Ms. Church is from St. Albans, VT, which is also, and even Casper, WY. But even though you have come a long way, I would ask you to be as brief as you possibly can and cover only ground that we have not already covered.

STATEMENT OF W.K. McGEHEE, JR., ARKANSAS CHAIRMAN, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, DC

Mr. **McGEHEE**. Thank you, Mr. Chairman. I appreciate the opportunity to come visit about Section 89. After listening to the faceless bureaucrat from Treasury, I had a great tendency to say I rest my case and leave.

I am here today as Arkansas chairman of the National Federation of Independent Business, which has over 6,500 members in the state strongly opposed to Government mandated benefits.

I also own a fire and burglar alarm company in Arkansas which has 18 employees who are covered by group health, life, and dental plan. The plan includes both employees and dependents.

We in small business are asking the Members to repeal Section 89. We view it like the enemy would view our Star Wars SDI Program. We fear it, we do not understand it, we do not know how to deal with it, but we are fairly certain it is going to get the best of us.

Last time I checked, the United States was operating a capitalist society. In America the successful entrepreneur has a right to some rewards. Remember, if there is no reward, there is no incentive. With no incentive, there are no risk takers who are the ones that start and expand businesses. They create jobs, make the payrolls, and provide affordable health care plans for their employees.

The employees' side, without the possibility of reward, there is no incentive to achieve or produce with quality. The authors of Section 89 say tightened rules will broaden health insurance coverage for workers. I totally disagree. From talking to my fellow small business owners, I can assure you that Section 89 will not improve or broaden the base of health insurance benefits. It will do just the opposite.

My attorney and accountant advise me we are going to have to spend thousands of dollars to put our plan into very precise writing and notify our employees in such a way that the plan is "legally enforceable against us."

Legally enforceable—this breeds of the sue, sue syndrome that has clogged our courts and hampered the ability of business to expand, employ people and reward productivity. One thing we do not need is another Government program that breeds lawsuits.

The business owners of America are going to have to make some tough decisions. In my business I have the choice of enduring the punishment of more Government paperwork to prove that I can pass the tests outlined in Section 89 or I can delete dependent coverage on all employees, which would put a tremendous burden on them because most of them could not afford this insurance on their own.

The other option I have, which is the worst for the very people that Section 89 is supposed to help. I could elect to drop all insurance benefits on everyone and instead give each employee the same amount of money that I contribute to his insurance plan, and he can purchase his own.

Now, two things will happen. First, he will have to pay tax on this money, which leaves him with less money to buy insurance. Next, he is going to discover the insurance premium is much higher because he loses the advantage of group rates.

In Arkansas the minimum deductible you can get from Blue Cross on an individual policy is $500. In our group, it is $200. They do not even have dental plans available on individual basis. So, it will really hurt the employees.

Senator BOSCHWITZ. You have a dental plan?

Mr. MCGEHEE. Yes, sir, and it is not available on an individual basis to individuals.

I think there is some consideration being given to fixed limits for employees' contribution to insurance premiums. Then these amounts would have indexed increases based on minimum wage increases.

I can only assume that this was thrown in to appear to ease the pain of Senator Kennedy's minimum wage proposal. With rapid rising medical costs, it seems to me that the small business owner would be forced to pay the accelerating insurance premiums with little help from the employees. Or he will have to decrease his involvement with employees' insurance as I discussed before.

We are being told to comply with Section 89 but have no helpful guidance from the IRS. It is like being told we will be given a ticket if we speed on the highway, but nobody has told us what the speed limit is.

If we are going to have to endure Section 89, I ask you to delay the start of the game until 1990 so the IRS can put together the game rules which should be reviewed by employers and your Committee and get them to us, the players.

In my opinion, Section 89 is poorly conceived and will not attain the goals promised by the authors. As a small business owner and one of the 570,000 members of the National Federation of Independent Business, we urge you to recommend outright repeal of Section 89.

We ask you to join Senator Trent Lott in co-sponsoring S. 350. By taking this action you will preserve the freedom of choice for both employers and employees in choosing and paying for their health insurance. Thank you. And I would ask that my testimony be entered into the record as well as a copy of NFIB's testimony attached to it.

[The prepared statement of Mr. McGehee follows:]

NFIB

National Federation of
Independent Business

Suite 700
600 Maryland Ave. S.W.
Washington, DC 20024
(202) 554-9000
FAX (202) 554-0496

The Guardian of
Small Business

STATEMENT OF

W. K. (Mac) McGehee, Jr.

Arkansas Chairman of the
NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Small Business Committee

Subject: Section 89 of the Internal Revenue Code

Date: April 13, 1989

Good morning... Thank you, Chairman Bumpers and members of the Committee, for this opportunity to discuss how Section 89 affects the small business community.

Background

I am here today as Arkansas Chairman of the National Federation of Independent Business, which has over 6500 members in the state who are strongly opposed to government mandated benefits. I am a Director of the Arkansas Small Business Council, which is an arm of the Arkansas State Chamber of Commerce. In 1986 I represented Arkansas as a delegate to the White House Conference on Small Business, where one of the top concerns was mandated benefits. I also own Spurling Fire & Burglar Alarm Company, which has been operating for 39 years and serves over 100 cities and towns in Arkansas with offices in Fort Smith, Little Rock, and Springdale. We have 18 employees who are covered by a group health, life, and dental plan. The plan includes both the employees and their dependents.

My opinion of Section 89

We small business people are asking you to repeal Section 89. We view Section 89 like the enemy views our stealth bomber. We fear it, we don't understand it, we don't know how to deal with it, but we are fairly certain it is going to get the best of us. Section 89 looks to me like another version of government mandated benefits which will threaten the survival of our health plans as we know them. It also reeks of a social reform that we call socialism. The last time I checked, the United States was still operating in a capitalist society. In America, the successful entrepreneur has a right to some rewards. Remember, if there is no reward, there is no incentive. With no incentive there are no risk takers, who are the ones that start and expand businesses. They create jobs, make the payrolls, and provide the affordable health plans for their employees. From the employees' side, without the possibility of reward, there is no incentive to achieve or produce with quality.

Effect

The authors of Section 89 say the tightened rules will broaden health insurance coverage for workers. I totally disagree. From talking to my fellow small business owners, I can assure you that Section 89 will not improve or broaden the base of health insurance benefits -- it will do just the opposite.

My attorney and accountant advised me that we are going to have to spend thousands of dollars to put our plan into very precise writing and notify our employees in such a way that the plan is legally enforceable against us, the employer. We can no longer reward top management with fringe benefits that are different from the other employees' benefits. I am afraid tax policy may someday extend Section 89 nondiscrimination rules to wages and salaries so they can even out the tax benefits of income.

The business owners of America are going to have to make some tough decisions. In my business I have the choice of enduring the punishment of more government paperwork to prove that I can pass the tests as outlined in Section 89. Or, I can delete dependent coverage on all employees, which will put a tremendous burden on them because most of them couldn't afford insurance on their own. The other option I have is the worst for the very people that Section 89 is supposed to help. I might elect to drop all insurance benefits on everyone, and instead give each employee the same amount of money that I contribute to his insurance plan so he can purchase his own. Now two things are going to happen: first he will have to pay tax on this income, leaving him less money to buy insurance. Second, he would discover the insurance premiums much higher because he loses the advantage of group rates. Gentlemen, I really hope it doesn't come to this.

One of our NFIB members from North Little Rock is a car dealer with 90 employees. Upon being informed of Section 89, he decided to avoid any IRS problem. He reduced his health plan to its lowest level for all employees. Then he raised the salaries of higher paid employees so they could buy the extra coverage.

I understand there is some consideration being given to fixed limits for the employee's contribution to the insurance premiums. Then these amounts would have indexed increases, based on minimum wage increases. I assume this was thrown in to appear to ease the pain of Senator Kennedy's minimum wage proposal. With rapidly rising medical costs, it seems to me that the small business owner will be forced to pay the accelerating insurance premiums with little help from the employees. Or he will have to decrease his involvement in the employee's insurance, as discussed earlier.

We are being told to comply with Section 89 but have no guidance from the IRS. This is like being told we will be given a ticket if we speed on the highway, but no one has told us what the speed limit is.

If we are going to have to endure Section 89, I ask you to delay the start of the game until 1990 so the IRS can put together the game rules, get them approved, and get them to us, the players.

However, Section 89 is poorly conceived and will not attain the goals promised by the authors.

As a small business owner and one of the 570,000 members of the National Federation of Independent Business, we urge you to recommend outright repeal of Section 89. We ask you to join Senator Trent Lott in co-sponsoring S. 350. By taking this action you will preserve the freedom of choice for both employers and employees in choosing and paying for their health insurance.

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NFIB

National Federation of
Independent Business

SUBMITTED STATEMENT OF
NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Small Business Committee

Subject: Section 89 of the Internal Revenue Code

Date: April 13, 1989

Suite 700
600 Maryland Ave. S.W.
Washington, DC 20024
(202) 554-9000
FAX (202) 554-0496

The Guardian of
Small Business

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Mr. Chairman, on behalf of the more than half million small business owners who are our members, the National Federation of Independent Business (NFIB) is pleased to submit this statement of our members' concerns with section 89 of the Internal Revenue Code (IRC).

INTRODUCTION

NFIB applauds the committee for holding these hearings and the members of the committee who support the repeal of section 89 of the IRC. NFIB and its members strongly support repeal of section 89. We are concerned that section 89 will irreparably reverse the progress which is being made by the small business community to expand health insurance coverage for employees. We are concerned that compliance with section 89 will divert resources which could be spent on health coverage benefits. We are also concerned that section 89 will result in fewer employees being covered and that those who will still be covered will not be able to receive the same level of benefits as they did before Section 89 went into effect. We further believe that Section 89 will result in the de facto taxation of employee benefits -- something so far rejected by Congress.

We will demonstrate that section 89 is not justified on policy grounds, that it imposes an unrealistic compliance scheme on employers for testing plans and recordkeeping, and that the reality of section 89 flies in the face of its stated goals: to eliminate discriminatory health plans and to expand health coverage benefits to more employees. We will also comment on S. 654 and the IRS regulations.

POLICY BACKGROUND

Section 89 of the IRC was a part of the Tax Reform Act of 1986. In the President's Tax Proposals to the Congress for Fairness, Growth, and Simplicity (May 1985) the discussion of the reasons for tax reform, under the heading of "the system is too complicated", included the following:

> For some [taxpayers], it seems a difficult -- and sometimes even ridiculous -- administrative burden (emphasis added).
>
> Efforts to increase compliance within the framework of the current system seem not only to have reached the point of diminishing returns. They often seem to be counter-productive: They increase resentment and disrespect for a system that cannot long function without a firm foundation of public confidence.

Unfortunately the President's proposal then went on (in Chap 3, part A) to propose complicated and counter-productive non-discrimination rules for employer-provided health insurance and other fringe benefits. Without thoughtful analysis of effects, appropriateness, or costs, the President's proposal became one of the sources of the Frankenstein monster created in Section 89.

Efforts to increase the scope of non-discrimination rules that had previously been applied -- rightly or wrongly -- to pension plans have gone too far, having been applied to an area where they have proved to be truly counter productive, beyond the point of diminishing returns, and inducing resentment. Besides, health insurance and pensions are completely different products and face utterly different market forces.

The voluntary provision of employee health insurance by employers should be held to be in the same category as the President's proposal and Congress placed home mortgages, obligations to Social Security beneficiaries, disabled veterans, and charitable contributions:

> Only a limited number of special deductions and exclusions would be retained [in the tax code] principally those that are widely used, and generally judged to be central to American values.

Eighty five percent of the American population is now covered by health insurance -- the vast majority provided by employers -- up from 40% in 1940. So this exclusion is widely used, more widely used than the home mortgage interest deduction. Employer-provided health insurance is also certainly judged by the marketplace to be central to American values. After vacations, it is the most demanded and given fringe benefit in the labor market.

Section 89 purports to be an effort to increase health insurance coverage among the working poor and to eliminate alleged abuse of the tax code by employers who give themselves and their highly compensated employees better fringe benefits than their non highly compensated employees. Section 89 cannot possibly accomplish those goals.

The working poor don't have health insurance for a lot of reasons, but pernicious employer discrimination is not one of them. The majority of these employees don't have health insurance because they either choose not to purchase it or because their employers cannot afford to provide it. Section 89 only adds to the problem of affordability, and any variation on the current Section 89 will do the same.

As for the alleged problem of excessive benefits for the highly compensated, where is the evidence of this and who established the standards to determine excessiveness? Isn't the next logical step in tax policy to extend Section 89 nondiscrimination rules to "wages and salaries" in order to "even out" the tax benefits of income?

According to the Joint Committee on Taxation, the tax revenues to be raised by Section 89 were to be $72 million in 1988, $128 million in 1989, $140 million in 1990, and $154 million in 1991, or a total of $494 million over four years. Given that the tax expenditure analysis reveals that the cost of the exclusion for health insurance will reach more than $30 billion, section 89 did not appear to have been created to have a substantial revenue effect.

Nevertheless, the actual impact of section 89 now appears to be that it will raise substantial revenue because of penalties for failure to comply or because of employers dropping employee health plans and increasing employee cash wages by the amount of former contributions. Furthermore, the costs of getting into compliance and staying in compliance are enormous -- thousands of dollars a year, even for a small employer Section 89 has shown itself to be a classic case of diminishing returns and couterproductivity.

Section 89 is both legislative overkill and a poorly concealed attempt to extend the "comparable worth" theory to tax policy. It is blatant social engineering through the tax code and will only serve to further undermine voluntary compliance.

NFIB will continue to urge the repeal of Section 89 as long as its basic assumption holds that nearly all employers are perniciously discriminating against their employees at the expense of the taxpayers. After all the technical and compliance problems are dealt with, if that is possible, Section 89 is still an indictment of America's small business owners -- and we completely reject it.

SMALL BUSINESS EMPLOYEE BENEFITS

Fringe benefits have become an increasingly difficult problem for small business owners. Both employers and employees are being affected by the rising costs of health insurance premiums and health care in general. Employer-sponsored group plans are popular because they afford an employee an opportunity to obtain health coverage at a cost that is far lower than he could purchase as an individual.

Unfortunately the small business owner is coming under increasing financial pressure to maintain current levels of coverage while insurance premiums increase 20% to 30% or more each year. It is no secret that small plans cannot receive the same benefit of lower costs that some larger employers can because of the economies of scale. These cost increases are beginning to affect the types of coverages and options an employer can provide.

In surveys of NFIB members on fringe benefits, health insurance ranks as the most popular behind vacations, with nearly two thirds of NFIB members providing some level of coverage for employees. It is also increasingly popular for an employer to provide dependent coverage with some level of employee participation.

IRS REGULATIONS

The first part of the IRS regulations to implement Section 89 has been published, but does nothing to clarify the law, nor is there any evidence of an understanding of or sensitivity to the burdens the law places on small employers.. The regulations were not developed after sufficient analysis of either the law's effect or its paperwork burdens.

1. Failure of the IRS to Prepare an Analysis of the Impact of the Regulations on Small Business As Specified Under Executive Order 12991 and The Regulatory Flexibility Act.

The IRS has placed its usual disclaimer on these regulations and stated that the Section 89 proposed regulations are not a major rule as defined under Executive Order 12991 and that a regulatory impact analysis is not required. In addition, as the IRS considers the regulations to be interpretive, it claims exemption from the provisions of the Regulatory Flexibility Act (RFA).

The RFA was enacted in 1980 as an amendment to the Administrative Procedures Act, and requires all federal agencies to analyze the impact that their rules and regulations will have on small business. In attempting to provide unquestioned legitimacy to regulatory flexibility, the Act was incorporated as a new chapter in the Administrative Procedures Act to ensure that small business impact would be given due consideration in the normal rulemaking process as opposed to being treated as an exceptional circumstance.

The Senate Judiciary Committees' report on the RFA included the statement: "The committee believes that meaningful regulatory reform must be government-wide, enforceable, and coordinated with the legislative framework for the agencies." Clearly the congressional intent was to require all agencies and departments to comply with the RFA.

It is obvious to anyone who has taken the time to review the requirements of section 89 that the burden on a small employer, without the available in house specialist to review the new paperwork and compliance issues, is indeed major. It is also obvious that the impact of section 89 will be disproportionate on small employers because of their more limited capability to react to section 89.

Essentially, the IRS is buying into the basic premise of section 89 that closely held businesses have only discriminatory plans. Data gathered independently by NFIB and other organizations confirm that small employers are increasingly providing voluntary health care coverage to an increasing number of employees. However, small employers are limited by the increasing costs of health care and the rapidly escalating cost of dependent coverage. The rapidly increasing cost of dependent coverage requires an increasing rate of participation by employees to purchase this coverage. This is specifically where Section 89 hurts the most.

IRS deserves to be severely criticized for failing to perform even the most perfunctory analysis under the requirements of RFA or Executive Order 12991.

2. Estimated Paperwork Burden Determined Under the Paperwork Reduction Act

Under the paperwork burden analysis approved by the Office of Management and Budget (OMB), it has been determined that it will require all employers to invest 9 million man hours to comply with Section 89 or an average of 10 hours per firm.

This estimate is deemed sufficient time to collect the data, read and understand the law and regulations, and make the necessary computations.

This estimate is absurd on its face. With nearly 200 pages of proposed regulations, it will take more than 10 hours for any individual, even one knowledgeable in employee benefits issues just to determine what might need to be done, and what the questions might be.

OMB should require IRS to perform a more realistic analysis on the burdens of complying with section 89, but only after talking to small business owners and advisors.

Until a careful analysis is conducted, we fail to see how these regulations can either clarify the law or help its implementation.

The Section 89 Simplification Act, S. 654 Section by Section Analysis

Section 2. Establishment of simplified health arrangements -- a new Section 90 of the IRC.

A plan that qualifies as a simplified health arrangement will be exempt from the testing requirements of section 89. A plan will qualify for this treatment if:

1) the plan meets current section 89(k) qualification tests;

2) (a) 90% of all employees are eligible to participate in the plan, and
(b) all plans of the same type have the same employer-provided benefit; and

4) the cost to an employee for employee-only coverage cannot exceed $6.70/week or $13.40/week for dependent coverage. These levels indexed to minimum wage increases.

Comment

This approach begins to acknowledge that "availability", not "participation", is the standard an employer should be held to. However, the maximum employee contribution levels are unrealistically low, especially for dependent coverage. Indexing the levels to minimum wage increases ensures that they will become even more unrealistic. Fixing employee contribution levels into the law and requiring the same employer-provided benefit does not allow for strategies to improve health care utilization.

The bill makes a slight movement in the right direction as written. An effective "safe harbor" would help get some employers out from under Section 89, but would also be bad health care policy.

A better, more workable idea might be to replace Section 89 entirely with a simple requirement that a qualified health plan not preclude low-paid workers from participating, and that all plans be available to all, or nearly all, of the full time workers.

Section 3. Treatment of part-time employees.

The definition of a part-time employee would change under Section 89. The new schedule would replace the current section 89 standard of 17 1/2 hours as the threshold for exclusion, as follows:

1989 -- 30 hours per week
1990 -- 27 1/2 hours per week
1991, and after -- 25 hours per week

Comment

Part-time workers are disproportionately employed by small firms. While the proportion of part-time workers and typical time worked varies by industry and region of the country, using 17 1/2 hours per week as the threshold to be treated like a full-time worker is completely unrealistic for small firms. Any threshold very likely will decrease the hours a part-time worker is able to work. Furthermore, in many areas of the country you cannot now buy insurance for part timers working less than 30 hours per week.

The proposal is certainly an improvement, although 30 hours per week would be preferable as the final threshold if part timers must be included with full- time employees at all. Part timers are different for an employer than full-time employees, therefore it is legitimate and appropriate that they be treated differently for benefits.

Section 4. Simplifications and Clarifications of Section 89.

A) Penalties that might be assessed for failure of a plan to meet the qualification tests would only be assessed against highly-compensated employees as opposed to all employees.

Comment

This is a marginal improvement, but it fails to address problems with the qualification tests themselves, e.g., the definitions of notification, legally enforceable, and permanence. It also penalizes some employees for actions outside their control and does so retrospectively.

Section 89 and this modification seem to be predicated on the belief that there is a class conspiracy of the highly compensated against the less than highly compensated and that, therefore, everyone in the class of highly compensated employees should bear the responsibilities for the decisions of a few of them.

B) The value of the benefits assessed for a failure to meet the qualification tests would be the full value of the insurance coverage or the COBRA cost as opposed to the value of insurance benefits received.

Comment

If this means premiums, then it is an improvement. The Section 89 language of including all benefits received in income will cause untold injustices unless changed in this direction.

C) Section 89 nondiscrimination testing will not apply if there are no "highly-compensated" employees. The change removes the requirement that in the absence of a "highly-compensated" employee, otherwise defined, the highest paid employee will be deemed a "highly-compensated" employee.

Comment

By failing to change the definition of "highly-compensated" employee, this probably only helps public organizations and non-profit organizations. The definition of "highly compensated" in Section 89 is so inclusive concerning ownership percentages (5% makes one an owner) that typical small business owners making less than $30,000 a year are considered "highly compensated". This is, therefore, another very marginal improvement.

D) The so-called one time a year testing rule of Section 89 would be modified so that if a "highly compensated" employee changes coverage during a year, additional testing will not be required.

Comment

Under Section 89 almost any life event of a "highly-compensated" employee would trigger a new round of testing and data collection for employer plans. Therefore this proposal is a good one.

E) Deemed coverage rule -- If under an employer-sponsored plan 80% of the non-highly-compensated employees benefit from employee-only coverage, and if all these employees are able to elect dependent coverage on the same basis as a "highly-compensated" employee, and if the maximum non-highly-compensated employee contribution for dependent coverage does not exceed $13.40 per week, then the dependent coverage would be deemed to satisfy the 80% benefits test of Section 89 and no further testing would be required.

Comment

This would be a simplification if anyone qualified. The limitation on employee contribution makes it unlikely that many plans would qualify. Furthermore, it is built upon the 80% participation test for employee-only coverage when a fairer test would be based on availability from beginning to end.

F) Aggregation rule -- Under Section 89 two plans are comparable and can therefore be aggregated for testing purposes if the difference in costs for "highly-compensated" and non-highly-compensated employees is no more than $100 per year ($8.34 per month). The proposal here is to change this to $365 per year ($30.42 per month).

Comment

Probably of minor positive affect now and of even less use in the years ahead.

G) Valuation of Coverage -- Under present law, a transition rule allows an employer to value coverage by a "reasonable method", specifically mentioning using the employer's premium cost. This proposal is to make the transition rule permanent.

Comment

A good simplification.

Conclusion

Section 4 (simplification) only begins to approach needed reforms. It makes minor changes around the edges of Section 89 without addressing any of its underlying substantive problems. It also falls short of solving the law's complex compliance nightmare and the onerous manner in which penalties are imposed retroactively.

Small Business Reactions to Section 89

We have devoted our discussion of Section 89 to some of the more technical aspects. In closing, we share with the Committee some of our member's comments:

Arkansas

"Section 89 of the Internal Revenue Code is a disaster for small business. This is a paperwork nightmare and will stymie any fringe benefits package for employees."

Batesville

"I beg of you to repeal Section 89..."

Quitman

"Wouldn't F.S.C. be better off if we just gave our employees a raise, dropped all benefits and let our employees buy their own..."

Blytheville

"It looks as though the government is trying to systematically put all small, small businesses out of business..."

Magnolia

"I can't get my work done for always fighting the powers that be in Washington, what is wrong with people up there?"

Hot Springs

Georgia

"The paperwork and liability associated with Section 89 will force us to reduce or eliminate some or all of those benefits."

Norcross

"I suspect that this is the first step toward taxation of all fringe benefits."

Whitestone

"Where will it stop?? When benefits are mandated, we plan to close shop and retire."

Clahoun

"We plan to cancel our group plan and give compensating pay raises, unless Section 89 is repealed."

Mooney Mtg. Co.

Oregon

"The additional costs are real costs that reduce our small bottom line further.
We have stopped considering the addition of any benefits because the complexity of compliance to Section 89 is so great."

Portland

"I for one am tired of being pictured as a modern day Simon Legree, preying on my employees..."

Tualatin

"We have never had the ambition to go into the insurance business and we do not think the government should mandate a law requiring that we be insurance experts."

Tualatin

"This is another case where a law creates more harm than accomplishments, feeding upon itself and again placing more power in the hands of incapable bureaucracies."

Sherwood

"Our office manager has been to two workshops, and has spoken to our attorney twice, and we still barely know where to begin... Section 89 is going to generate millions of dollars for lawyers, tax consultants, financial advisors, and the IRS... Put pressure on Dan Rostenkowski to scrap this bill.

Albany

Texas

"I am afraid that a lot of us will just abolish all fringe benefits for our employees... For the sake of the employees of small business I urge you to cosponsor Bill S. 350 to repeal Section 89."

Port Arthur

"I strongly support the concept of non discrimination in employee benefits plans, but whoever came up with the tests in Section 89 must be trying to discourage companies from providing benefits... I have a programming estimate of $2,200 to get the employee information aligned in preparation for the expected test calculations."

Austin

"We consider Section 89 to be nothing less than another intrusion of government into the affairs of small business. Also, whatever happened to the PAPERWORK REDUCTION ACT passed by Congress not too long ago?"

El Paso

"Due to the horrendous cost of trying to comply with Internal Revenue Code Section 89, we plan to discontinue offering health insurance for our employees... In attempting to help one segment of the population by punishing another segment our government has gone crazy. We have previously discontinued profit sharing and retirement benefits because of impossible regulations."

Corpus Christi

"I strongly urge you to repeal Section 89, and let the free market determine the wages and benefits provided to employees..."

RTC/Partners Inc.

vas/0353T

APPENDIX A

Overview of Section 89

1. Qualification Tests

Section 89 imposes new rules on employers to establish health insurance plans that are "qualified". To be considered a "qualified" plan, an employer must take the following steps and meet the following requirements:

1) have the plan in writing;
2) provide that an employee's rights under the plan is legally enforceable;
3) provide employees notification of benefits available under the plan;
4) illustrate that the plan is for the exclusive benefit of employees; and
5) determine that the plan was established with the intention of being maintained for an indefinite period of time.

2. Eligible Employees

The employer must determine which employees must be included in the plan. To do this the employer must determine which employees must be included in testing, which employees may be excluded from testing, and most importantly, which employees are highly compensated.

*Excludable Employees

For testing under section 89, an employer may exclude employees who:

1) have not completed six months of service;
2) normally work less than 17 1/2 hours per week;
3) do not work more than six months per year;
4) have not reached age 21; or
5) are covered under a collective bargaining agreement.

*Highly Compensated Employee

The definition of highly-compensated employees is particularly critical, for it is this group of employees and their level of benefits that will be compared to all other employees to determine if the plan is discriminatory. Highly compensated employees are defined as:

1)owners who own 5% or more of the business;

2)employees who are earning more than $50,000 or who are among 20% of the highest paid workers;

3)employees earning more than $75,000; or

4)an employee who was at any time an officer of the business and received compensation greater than $45,000.

3. Defining Employers

Under the rules of section 89, related groups or commonly-controlled organizations must be combined for purposes of testing under section 89.

4. Determine Which Plans Must be Tested

Section 89 applies to the following type of employee benefit plans:

1) accident and health plans;
2) group term life insurance plans;
3) group legal service plans;
4) educational assistance plans;
5) dependent care assistance arrangements;
6) tuition reduction programs;
7) cafeteria plans;
8) Voluntary Employees' Beneficiary Association Plans;
9) supplemental unemployment benefit plans; and
10) fringe benefit programs, including employee discount programs, and subsidized cafeteria facilities.

In defining which plans are to be tested, an employer is required to test each separate benefit option as a distinct and separate plan. The most common example of such a situation will be an employer health plan that offers one option of employee coverage, another option for dependent care coverage, the option of a typical insurance carrier, or an HMO.

5. Non-Discrimination Tests

*Employee Data

For each employee a substantial amount of new data must be collected and updated annually. The type of data required will include the following for each employee:

1) name and Social Security number;
2) date of birth;
3) date of hire;
4) compensation (both cash and non-cash);
5) benefit elections for accident or health plans;
6) with regard to health plans, sworn statements demonstrating the coverage elected by the employee, whether the employee has dependent family members, and whether the employee or any of his dependents have core health coverage maintained by another employer;
7) with regard to employees, whether any divorced spouses may have claims on the employee's health coverage;
8) the employee's pre-tax and after tax contributions to each plan;
9) the employer's contribution to each plan;

10)the divisions the employee is a part of; and

11)whether the employee is considered part time or full time for purposes of section 89.

*Percentage Tests

Having made all of these determinations, the employer must finally begin the actual testing of his plan. There are two routes to take in this regard. Some employers with simple benefit plans may qualify for the simpler testing method: two tests , one quantifiable and one subjective. All others must use a series of four tests, three quantifiable and one subjective.

Those with simple benefits plans must meet an 80% coverage test, which requires that 80% of all non-highly compensated employees be covered under each plan being tested. Failing this test, which the more complex plans will, requires a three-part test:

1) At least 50% of all eligible employees must be non-highly compensated employees;
2) At least 90% of the employer's non-highly compensated employees must be eligible for a benefit that is at least 50% as valuable as the health benefit available to the highly compensated employees with the highest available benefits under the plan; and
3) the average employer-provided benefit received by the non-highly compensated under all plans of the type being tested must be at least 75% as rich as the average employer-provided benefit received by highly-compensated employees.

All plans must also be tested against a subjective non-discrimination test that requires that plans not discriminate in any non-qualifiable way.

6. Valuation of Benefits

The benefits that each employee is to receive must be valued according to regulations which the IRS has failed to issue. The valuation table that will be introduced will be the basis upon which any discriminatory benefits will be taxed.

APPENDIX B

Suggestions for Modifying Section 89

Based on information from NFIB members and practitioners, the following are specific suggestions for changes in the statute to improve its workability. Were all these suggestions adopted, we believe the law would still be objectionable, however.

1) Qualification Rules

Failure to pass any one of the qualification tests prescribed under Section 89 results in total failure of the plan to qualify. Failure to qualify results in penalties imposed on both the employer and the employee. Employees would be taxed on all benefits paid by the employer-sponsored plan. Simultaneously an employer is held responsible for failing to withhold federal taxes and social security taxes on this additional income. He/she also incurs a liability for a special excise tax.

A. Definition of Legally Enforceable

For the purpose of defining this term under section 89, a "legally enforceable" benefit must be clearly defined to limit the employer's liability to those benefits paid for by the employer as provided by the insurance carrier.

The term "legally enforceable" within the context of Section 89 causes concern among many business owners and advisors. While ERISA provides guidance, under ERISA the definition of an enforceable employee right depends on an imprecise interaction of federal and state law. In some circumstances state law prevails; in others, federal law prevails.

Using ERISA pension rules as guidance is a mistake, because under ERISA the creation of a pension plan results in a contract which exists between the employee and the employer. This contract is what creates the right under ERISA. Expanding the ERISA guidelines to health insurance policies implies that the IRS regulations can be used to set the guidelines for a minimum level of health insurance.

Even worse, under most health policies the carrier sets the schedule of payments in conjunction with the provider, who may decide the necessity and reimbursement level of a specific medical procedure. The employer does not have any part in these discussions except to continue to pay bills.

Under the current definition of "legally enforceable", the employee may have a right to challenge the employer for additional benefits that the carrier might not cover.

In summary, we want the statute to reflect the clearest definition that the employee is only entitled to the benefits the employer has purchased, within the restrictions of applicable state and federal law. We do not want to provide the bureaucrats with an opportunity to define minimum benefit levels to qualify a plan for deductibility. Nor do we want the law to grant, however inadvertently, a benefit to an employee that was never intended or that is greater than the health policy or state law provides. It must be clear that the legally enforceable standard provides no claim on benefits from the employer other than those purchased from the insurance carrier.

B. Reasonable Notification

An employer should be required to provide notification of benefits only to new employees or when the policy benefits change. Notifications should not commence until nine months after final regulations are in place.

Similar to notice restrictions under ERISA, this recommendation targets notice requirements to cover necessary situations, thereby maintaining reporting burdens at a reasonable minimum level and allowing for a reasonable time period for employers to become informed about their responsibility under the law.

C. Requirement that Plan Benefits Be Indefinite

This requirement should be eliminated. It is too vague and duplicative of the other restrictions being created.

This provision will scare away small employers from establishing health plans. For small employers "indefinite" means the end of the next billing cycle. This requirement is too vague to be enforceable and should be deleted.

D. Penalties for Failure to Meet Any of the Qualifications Standards

The penalty should not be imposed on employers until two years after issuance of final IRS regulations. After that point, good faith efforts at compliance and minor technical violations should not be penalized.

This time frame allows employers and practitioners to become familiar with the Section 89 rules. In addition current law makes no distinction between flagrant, serious violations and minor or unintentional violations. The punishment should, in all fairness, fit the crime. Furthermore, considering that most plan failures will not come to light until after a return is filed, Section 89 imposes penalties retroactively-completely ruining anyone's ability to make financial plans.

E. Withholding Rules

A plan should not be required to begin withholding until the year following the plan year in which an event triggers the need for withholding of FICA or Federal withholding taxes.

The current Section 89 withholding rules create uncertainty in the future for employers and employees. Moving the effective date of withholding rules into the future reintroduces some level of certainty, allowing for appropriate planning to meet the unexpected liability.

F. Taxation of Benefits

Taxation of benefits should be done prospectively only, in the year after a plan fails to qualify.

For both a business owner and an employee, one of the biggest problems section 89 creates is the uncertainty that a plan will be qualified. Employers and employees may face uncertain tax liabilities. Prospective taxation allows employees and employers alike to make adequate adjustments to cover the financial shortfall resulting from unplanned tax liabilities.

2. Eligible Employees

A. Excludable Employees

If an employee works less than 30 hours per week, he/she should be excluded from coverage tests and not have to be notified under any of the qualifications tests.

Also, an employee may choose not to participate in any employer-sponsored benefit plan. If he/she notifies the employer in writing that he/she elects non-coverage, the employee should then be excluded from any testing.

These suggestions are key to small business owners. Section 89 arbitrarily sets the definition of a full-time employee as someone who works at least 17 1/2 hours per week. Therefore a plan is discriminatory if it does not cover these employees.

This arbitrary definition has no basis in the economic realities of small businesses. Employers find it difficult enough to maintain coverage for full-time employees. It is not discrimination; it is a reflection of what business owners can afford to provide.

Forcing an employee to elect coverage to prove an employer's lack of dicrimination is absurd. Testing should include only those who want the coverage. Those who elect no coverage do so with the knowledge that they accept the financial risks of no coverage. It is not discriminatory to test only those who are eligible and elect coverage.

B. Definitions of Highly-Compensated Employees

A highly-compensated employee should be defined as an individual earning more than $65,000 per year and who is a 15% or greater shareholder, or has an equivalent ownership in an unincorporated business or partnership.

The current definition of highly compensated is not an accurate reflection of which employees are exercising true control in a business. Generally, stock or ownership incentives are given to a key employee who has been with the business for the long term. These ownership benefits are typically granted with many restrictions by the employer and do not make the employee an equal owner in the business. They are granted to hold onto a highly valued employee.

In trying to define when an individual begins to exercise true control in a company's affairs, it would best be described by a level of equity closer to 15% of total stock.

As for levels of compensation which truly define highly compensated, $50,000 is too low. A level of $65,000 is a more realistic number for defining a highly-compensated individual in the context of the diversity of small businesses.

In addition both requirements should be in effect for an employer/owner to be considered highly compensated. Many small business owners do not have high incomes by anyone's standards. Business ownership alone should not automatically translate into "highly-compensated".

3) Related Entity Rules -- Defining Employers

The related entity rules should not apply if the lines of business have no direct relationship. For example, if one individual has two subsidiaries, one wholesale and one retail, they would be combined under Section 89 for testing purposes. However, if an individual owns a retail operation and a real estate holding company, the two should not be combined unless their operations are directly related.

Section 89 requires that all commonly-owned businesses be combined for purposes of testing discrimination. Under this rule employees of two unrelated businesses having common owners will have to be included as one group in the discrimination testing.

Related entity rules are intended to prevent an individual from claiming more than one corporate surtax exemption in a closely-held business. Extending these rules to apply to Section 89 discrimination tests is illogical and circumvents the realities of the marketplace.

In each business the demands of the marketplace may set widely different demands on fringe benefits. The related entity tests are valid only where the operations are related directly, such as a wholesale and a retail operation handling the same product. In this case all employees should be tested together.

However, the current rules are too encompassing and require entities to be combined for testing under circumstances which are unrealistic and may actually harm employees.

4) Data Collection

A. Employee Data Requirements

When drafting regulations detailing data requirements, recordkeeping rules, and testing requirements, the IRS must adhere to the statutory requirements of the Paperwork Reduction Act and the Regulatory Flexibility Act.

The Paperwork Reduction Act and the Regulatory Flexibility Act require the IRS to consider whether the paperwork or recordkeeping burdens on small business are disproportionate to those on large firms. Tailoring regulations to fit the resources of small firms is clearly authorized and encouraged by these acts.

Adherence to the guidelines which these two acts provide will therefore reduce unnecessary paperwork and recordkeeping requirements.

B. Data on Former Employees

Former employees should not be tested under any circumstances.

Requiring the testing of former employees, even when there is an overlap in a plan year, is unrealistic. The tests should be performed only on those employees who are currently employed and currently electing to participate in a fringe benefit plan offered by the employer.

5) Non-Discrimination Tests

A. Testing Rules

Employer-sponsored plans should not be required to perform anti-discrimination tests if any of the following circumstances exist:

1- for businesses in operation less than three years, or for businesses with fewer than five (5) employees;

2- if 80% of those eligible and electing to participate in a fringe benefit plan are non-highly compensated employees (reference new definition of highly compensated under section 2-B);

3- if there are no highly compensated employees (reference new definition of highly compensated under section 2-B); or

4- if the employer pays 80% or more of all plan costs for all employees who elect to participate in employee only plans; a 70% threshold applies to all who elect dependent coverage.

The result of each test is that discrimination is severely limited. Even under Section 89 as it is, discrimination is never fully eliminated. Part of the question section 89 raises is how much we should pay to ensure against the small percentage of plans that discriminate against employees,

B. Time For Testing

1- Testing should begin for employee-only coverage one year after final regulations are in place.

2- Testing should begin for dependent coverage two years after final regulations are in place.

After the section 89 rules are replaced with a new section 89 format, the IRS will require time to promulgate new regulations. Taxpayers will need time to understand the new rules, and practitioners will need time to become sufficiently familiar with the new rules to advise their clients properly.

A one-year time frame for testing employee-only coverage is reasonable because this gives all parties sufficient time to understand the requirements. When options such as dependent coverage or other plans such as HMOs come into play, the problems are more complex. Employers and employees will need additional time to reconfigure their plans and adapt to the new rules.

Senator **Boschwitz**. This was not the NFIB's testimony?

Mr. **McGehee**. No, sir, I have that with me.

Senator **Boschwitz**. I do not have a copy of that here in my book, and it certainly will be. You are just the kind of witness we need, having 18 employees, and so forth.

Now, we turn to Ron Morris of True Oil in Casper, WY.

STATEMENT OF RONALD M. MORRIS, TAX COUNSEL, TRUE OIL AND AFFILIATED COMPANIES, CASPER, WY

Mr. **Morris**. Mr. Chairman, first I would like to thank Senator Wallop for offering the opportunity for someone from our organization to come and speak today. We appreciate his concern on this very important issue.

I am in-house tax counsel for the True Companies. The True Companies is a group of family-owned companies engaged in oil and gas exploration and production, drilling, crude oil brokering, and other aspects of the oil and gas business, as well as ranching. We employ 475 people, most of them in the Rocky Mountains and North Dakota.

As I indicated, ours are family-owned businesses. They have a real family spirit. For that reason, for more than 30 years the family has offered to all the companies employees a uniform health insurance policy available for all employees who work more than 20 hours per week.

Now, perhaps with 475 employees, we are not the typical small business. I am here today to tell you that medium-sized businesses like ours have just as much difficulty complying with Section 89 as small businesses.

We are unusual in that we have an in-house tax attorney. We also have a tax consultant with more than 30 years experience as well as a very sophisticated computer system. Nevertheless, we have been unable within our shop to develop the expertise on Section 89 to do the testing and qualification work.

The tax personnel simply do not have the ability, the time, the resources to develop an expertise on Section 89 to analyze our plans, to set up the necessary data-gathering mechanisms, run the tests, and then be prepared to advise the companies—the family—on how to handle plan redesign.

We have spent to date approximately $50,000 on compliance work, and we still have a good deal of work to do. We found it necessary to go outside the company to hire a Midwest-based accounting firm to provide us with some advice on Section 89. One of their CPAs came from Rochester, MN and spent most of a week helping us assemble our data-gathering system. Their fees, including out-of-pocket costs for travel, were about $11,000.

Our in-house staff has spent more than 185 hours so far in setting up and doing the data collection. So, it is apparent Section 89 is not workable. It is not workable for small businesses and it is not workable for medium-sized businesses either.

We do not think that delaying the effective date of Section 89's non-discrimination testing is the answer. A delay will provide an opportunity for the issuance of administrative guidance, but a lack of administrative guidance is not the problem for small- and medium-sized businesses. They simply do not have the capacity to carry out this convoluted, difficult, complex testing. In fact, once we get more regulations, these new regulations will probably be just as difficult as the first set, ensuring the dependence of small- and medium-sized business on the various consulting services that have sprung up.

America's employers have for a long time been free to plan health insurance programs that meet the needs of their employees, geographic location, the needs of the industry and other factors. And, as a result of this, there is a great variation in the plans offered by American businesses.

We believe that any participation-based non-discrimination formulas will necessarily be too complex to be administered by small- and medium-sized businesses. Therefore, we think it is time to go back to the drawing board and repeal section 89. Thank you, Mr. Chairman.

[The prepared statement of Mr. Morris follows:]

Testimony of
Ronald M. Morris
Tax Counsel
True Oil and Affiliated Companies

On

Section 89 of the Internal Revenue Code

Before the
Committee on Small Business
United States Senate

April 13, 1989

Mr. Chairman and members of the Committee, I am Ronald M. Morris, in-house tax counsel for the True Companies in Casper, Wyoming. The True Companies is a group of closely held businesses engaged in oil and gas exploration and production, drilling, crude oil brokering, oilfield equipment sales, the operation of a crude oil pipeline, trucking and ranching. We employ 475 people, most of them in the Rocky Mountain states and North Dakota. Today I am appearing on behalf of the companies to describe our experiences in attempting to comply with Section 89. I will also comment on legislation to modify or repeal Section 89.

We are pleased to have this opportunity to submit this testimony on the adverse impact and cost of Section 89 to our business. For more than 30 years the True family has been committed to providing adequate and uniform health insurance coverage, as well as adequate life insurance, for their employees. Our experiences in attempting to apply Section 89's testing requirements to these two relatively simple benefits suggest the nightmare these requirements represent to small and medium size businesses. We believe that such businesses simply cannot commit within themselves the resources necessary to understand, least of all carry out, the complicated testing procedures and the cumbersome qualification requirements. If they wish to comply with the law, these businesses have two choices: either hire expensive outside assistance or terminate the plans. We agree with those legislators who have observed that small businesses should not be put to this choice and that Section 89 should therefore be repealed.

SUMMARY

Our experience with the Section 89 nondiscrimination testing procedures convinces us that no small or medium size business can carry out the complex testing requirements without expensive outside assistance. These businesses simply do not have the capacity in house to go through the time-consuming process of educating themselves on Section 89's requirements, identifying various potential "plans" for testing purposes, applying the various comparability and aggregation rules, and then performing the tests themselves. Most small business owners can't make what are essentially legal judgments as to who among the contract help are leased employees. Nor do such businesses have the resources to properly value any discriminatory excess or to reliably modify their plans to conform to the Section 89 requirements.

Compliant small businesses can only respond by attempts to simplify the testing process through elimination of benefits like dental and vision coverage, or by terminating their health and life insurance plans. We think the Section 89 testing requirements are encouraging companies to drop their employee benefit plans rather than meet the costs associated with outside consulting services. Also, we suspect that many new companies that should be encouraged to cover their employees are deciding not to offer such benefits at all because of the complexities of compliance.

Modification of the regulations issued March 2, 1989 is not the answer. These proposed regulations are but the first installment of several. The more complex issues involving Section 89 have been left for later regulations projects. We're in for years of tinkering with regulations. The solution is the repeal of the Section 89 testing requirements.

SECTION 89 COMPLIANCE BY THE TRUE COMPANIES

In the next few minutes I would like to describe in general terms our companies' benefit plans, our experiences with Section 89 compliance and what this compliance has cost us to date.

Despite their disparate and geographically dispersed business activities, our various companies maintain uniform health and group life insurance plans. The health plan offers basic medical and surgical benefits for either a single employee or for the employee and any number of dependents (the "family plan"). So as to help reduce turnover and provide an incentive for longevity, the company pays an increasing portion of the premium with additional years of service. The company pays 50% of the premium for those with less than 5 years of service, 75% for those with between 5 and 10 years of service and 100% for those with more than 10 years of service. All employees working more than 20 hours per week are eligible to participate and choose the coverage they desire, although hourly employees have a 6-month waiting period.

The companies' group life insurance program offers life insurance in an amount based upon 4 salary brackets, up to a maximum coverage of $50,000. For example, those who earn between $10,000 and $15,000 may purchase $30,000 of insurance, those earning between $15,000 and $20,000 may purchase $40,000 of insurance, and so on. As with the health plan, the companies contribute to the premium cost based upon years of service.

Although the two plans are fairly basic with uniform benefits and broad eligibility rules, we knew immediately that Section 89's testing requirements were so complex that they could not be performed in house. Just one aspect of the testing requirements illustrates the problem.

Under Section 89, a "health plan" for testing purposes is a uniform entitlement provided to employees with respect to payments on account of personal injury or sickness, including specific medical claims, expenses, products or services. Any difference in entitlement creates separate health plans. In addition, any difference in cost to different groups of employees creates separate plans. Each option as to coverage is treated as a separate health plan. Analogous rules apply to separate coverages and employee costs with regard to life insurance plans. For some testing purposes comparable plans are aggregated, although the comparability rules are different depending upon which test (coverage, eligibility or benefits) if being performed.

The application of these rules to the companies' life insurance program produced this result: Our life insurance program is, for testing purposes, 475 separate plans. Our outside tax consultant, the Section 89 expert we retained and I agree that our life insurance plan is virtually untestable under Section 89.

On the other hand, our very simple health plan breaks down into 12 plans. The health plan is therefore at least capable of being tested. If the company offered additional options, such as vision and dental care, the number of plans to be tested may have been closer to 50. Only one of our 12 health plans failed. We are therefore facing redesign of our entire health insurance program because of the testing results concerning only one plan.

Our Section 89 compliance work to date has cost the companies approximately $50,000 and much of the qualification work remains to be done. Because of the complexity of Section 89, we felt it necessary to obtain the advice of benefits experts from McGladrey & Pullen, a midwest-based accounting firm. One of their CPA's spent most of a week in Casper assisting us with data collection so that the testing could be performed. The cost of these services, including out-of-pocket costs for travel and lodging, were more than $11,000. The data collection process required more than 185 man hours by our in-house staff. We are not looking forward to performing the data colleciton and testing on an annual basis. We're also apprehensive that changing salaries, changes in our workforce or changes in our business activities may require frequent plan design changes.

Unlike most small companies, we have a fulltime in-house tax attorney. We also have available the services of a tax consultant with more than 35 years' experience and sophisticated computer equipment. Because of the complexity of the Section 89 testing and the substantial penalties for noncompliance, even these resources were not sufficient for us to perform all the elements of Section 89 compliance. We could not abandon other tax work in order to analyze the law, attempt to reach the correct legal conclusions on such issues as what plans exist for testing purposes, which are comparable and which may be aggregated, and which of our contract employees might be leased employees for purposes of the testing. Nor could our tax people do this work and, in addition, organize the necessary data collection procedures, see that the various tests were properly performed and then assure the companies' owners that we could provide reliable advice on any necessary redesign of the benefit plans.

Small and medium size businesses simply can't afford to develop the in-house expertise on these complex procedures. Nor do they, in most cases, have the personnel capable of making reliable decisions on how the statute and regulations might apply to their plans. Without the ability to perform these functions, the typical small business wishing to comply with the law and retain its benefits can do none other than hire an expert, carry out the expert's instructions on data collection and use its best efforts to follow up on the expert's recommendations on plan redesign. The only real alternative to this expensive and burdensome process is termination of the benefit plans.

Small businesses should not be put to these choices. Nor should a growing young business be made to choose between assuming Section 89's compliance burden or denying its uninsured workers basic health insurance coverage.

PENDING LEGISLATION

Delaying the effective date of Section 89's nondiscrimination testing is not the answer. Although such a delay will provide more time for the issuance of administrative guidance, a lack of guidance on technical issues is not the source of the difficulty for small businesses. In fact, more regulations will simply insure the dependence of small businesses upon Section 89 consulting services, which are already one of America's fastest growing cottage industries.

America's employers have been free to design health and group life plans that reflect the size and needs of the particular business, the geographic location, the requirements of the particular industry and other factors. As a result of this freedom, there exist enormous variations in plans offered by American businesses. Also as a result of this freedom, employer-sponsored health plans have flourished. We believe that if any participation-based nondiscrimination formula is to treat all such plans fairly, it will of necessity be too complex for small and medium size businesses to administer. Therefore neither delay of Section 89's implementation nor tinkering with its testing formulas is the answer. The answer is the repeal of the nondiscrimination testing requirements.

CONCLUSION

We believe that both businesses and their employees benefit from adequate health insurance plans with broad eligibility standards. We also agree that, as a matter of public policy, tax-favored employee benefit plans should not favor the highly compensated through better benefits or more favorable eligibility rules.

Nevertheless, these public policies must be furthered in ways that acknowledge the limitations of small businesses and their need for straightforward, workable guidance.

Senator BOSCHWITZ. I think that may indeed happen, and I thank you, too. You are in the oil business?

Mr. MORRIS. Yes.

Senator BOSCHWITZ. Are you a member of the family?

Mr. MORRIS. No, I am not. I am just the in-house tax attorney.

Senator BOSCHWITZ. Too bad.

Mr. MORRIS. Indeed. Thank you.

Senator BOSCHWITZ. Put yourself up for adoption.

All right, Ms. Earlyn Church, we now turn to you. You are from St. Albans, VT.

I would say to Mr. Morris that Senator Simpson is also, of course, from Wyoming and when you see him, I happen to be one senior to him here in the Senate, and I wonder if you would be kind enough to remind him of that fact when you see him. I try to remind him often, but he does not seem to take it seriously enough.

As you know, he has a very rich sense of humor.

STATEMENT OF EARLYN CHURCH, CO-OWNER AND SECRETARY/TREASURER, SUPERIOR TECHNICAL CERAMICS CORP., ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, WASHINGTON, DC

Ms. CHURCH. Senator, I think I am the last speaker today. You are just about off. I am going to truncate my testimony and file a major copy and keep my statement strictly to what happened in my corporation and register the name of the trade association that I work with.

I am the owner and secretary-treasurer of Superior Technical Ceramics in St. Albans, and we make high tech ceramics. We have 85 employees.

I am here today also representing the National Association of Manufacturers, an association which has 13,000 members, 9,000 of which are small companies.

In our case we had to go through courses, testing, and we came up with an estimate of what it was going to cost us with 85 employees, again, a family-owned corporation. We have had full in-house benefits for all employees and in order to meet the requirements because there were so many different categories in our package, here are some of the figures that we were given.

I took 15 hours of training and the courses came up to $1,500. And those courses were offered by lawyers, a medical management company, and an accounting firm. In order for us to run the program in-house, we will need to purchase software, which will come to $10,000. The legal fees to obtain disclaimer statements from 85 percent we estimate at 15 minute each at $150 an hour, and I would say the legal fees in Vermont are a little cheaper than in Washington. So, that comes up to another $1,700.

Senator BOSCHWITZ. Fifteen minutes each with 85 employees is 21 hours at $150——

Ms. CHURCH. We came out to $1,750.

Senator BOSCHWITZ. That is $3,150.

Ms. CHURCH. All right, someone did the math wrong. Preparation of the testing of the plan would be 14 separate sections by an outside accounting firm has been quoted at $10,000. That is just the plan.

The analysis of the plan is going to be billed by the house, and we have no idea what the cap on that is.

We have an education part to our plan, and we do not know if that comes under the section and consequently we do not have an estimate on that. So, right now our total known out-of-pocket would be over $23,000.

As we approach this plan we realize that we could not administer it with our given staff, and so we went out and hired a human resources person at $28,000. And on top of that he has 40 percent of that in benefits.

In conclusion, section 89 is a major barrier to the expansion of employer-sponsored health coverage among small businesses and will lead some firms to significantly cut back existing coverage and in some cases drop benefits altogether.

Since coverage by small business is already lower, it seems unwise to further impede expansion. Rather, Government should consciously take steps to reverse the impact of this legislation.

We urge repeal of Section 89, and we would be pleased to work with you on this important effort.

We also have a number of letters and case studies of other companies that belong to NAM, and we would be happy to turn those over.

[The prepared statement of Ms. Church follows:]

MANUFACTURING
CREATES
AMERICA'S
STRENGTH

TESTIMONY OF
EARLYN CHURCH
CO-OWNER AND SECRETARY/TREASURER
SUPERIOR TECHNICAL CERAMICS CORPORATION

ON BEHALF OF THE
NATIONAL ASSOCIATION OF MANUFACTURERS
ON THE
IMPACT OF SECTION 89 ON SMALL BUSINESS

BEFORE THE
COMMITTEE ON SMALL BUSINESS
U.S. SENATE

APRIL 13, 1989

NAM
National Association of Manufacturers
1331 Pennsylvania Avenue, NW, Suite 1500 — North Lobby
Washington, DC 20004-1703 (202) 637-3000

The National Association of Manufacturers is a voluntary business association of more than 13,500 member companies and subsidiaries, large and small, located in every state. Members range in size from the very large to the more than 9,000 smaller manufacturing firms, each with fewer than 500 employees. NAM member companies employ 85 percent of all workers in manufacturing and produce more than 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and the National Industrial Council.

SUMMARY

IRS Code Section 89 nondiscrimination rules enacted under the Tax Reform Act of 1986 (PL 99-514) requires employers to test their tax-exempt employee benefit plans (accident, health and group term life insurance) to determine if such plans favor highly compensated employees over the rank-and-file. Rule violations result in stiff penalties on both employer and employee. Effective 1/1/89, Section 89 is creating costly administrative burdens for both small and large firms and should be repealed. NAM supports S. 350 (Lott R-MS) with 16 cosponsors and H.R. 634 with over 276 cosponsors. Broad bi-partisan support for this repeal measure clearly demonstrates Congress' deep concern over this issue.

To comply with Section 89, employers must collect, analyze, maintain and update massive amounts of data and then conduct complex eligibility and coverage tests. Ironically, while its original intent was to discourage discrimination and increase health insurance coverage, Section 89 will have the opposite effect and lead to cutbacks in existing benefits and termination of health insurance altogether, particularly for some small businesses. Not only is Section 89 bad health policy, it is also bad tax policy. Proponents insist that repeal would constitute a loss in tax revenue which must be offset per Gramm-Rudman-Hollings budget law. Yet, if all employers were able to comply, then no penalties or tax revenues would be collected.

The burden on small business is especially onerous. For example, Superior Technical Ceramics Corporation, St. Albans, Vermont, with 85 employees, estimates its compliance costs at $23,250 plus the cost of an additional staff position of personnel manager at $28,000 (plus 40% fringe) yearly. As a percent of profit, operating capital, and personnel available, such resource use is significant, and when multiplied by the many small businesses nationwide, one can appreciate the impact of this law.

NAM believes Section 89 to be so seriously flawed that modifications to existing law or tinkering with the IRS regulations could in no way begin to address the problems. Rather, Section 89 must be repealed. At the same time, we should look for positive and constructive ways to expand employer-sponsored employee benefits through reducing regulatory barriers (like Section 89) and providing tax incentives and selected other incentives.

Testimony of Earlyn Church
Co-Owner and Secretary/Treasurer
Superior Technical Ceramics Corporation

on behalf of the
National Association of Manufacturers
on the Impact of Section 89 on Small Business
before the Committee on Small Business
U.S. Senate
April 13, 1989

Mr. Chairman and members of the Small Business Committee, I am Earlyn Church, Co-Owner and Secretary/Treasurer of Superior Technical Ceramics, Corp., St. Albans, Vermont. Superior Technical Ceramics, which manufactures high-tech ceramics, employees some 85 people. Today, I am representing the National Association of Manufacturers. I am accompanied by Sharon Canner, NAM's Assistant Vice President of Industrial Relations. Of NAM's over 13,000 members, 9,000 firms have an employee base of under 500 workers and a large percentage of these have fewer than 100 workers. I wish to thank you, Mr. Chairman, for Holding this hearing and calling attention to the serious problems created by Section 89 and its adverse impact on the provision of employee benefits.

As discussed below, we believe that Section 89 is unworkable and should be repealed. We urge your support of S. 350/H.R. 634 (Lott R-MS and LaFalce D-NY). Legislation which proposes simplification or modification cannot fix Section 89 and should be rejected.

NAM has long advocated nondiscrimination in the provision of employee benefits as sound employee relations and economic policy. Section 89 runs contrary to that goal and is having a negative impact on all businesses that offer employer-sponsored health and welfare benefits. But since the scope of this hearing is focused on small business, we will confine our comments specifically to this group.

CONGRESSIONAL INTENT VS. ACTUAL EFFECT OF SECTION 89

The Tax Reform Act of 1986 (PL 99-514) added IRS Code Section 89 to require all employers--private firms, as well as state, local and federal governments and nonprofit entities--to test their tax-exempt employee benefit plans (accident, health and group term life insurance) to determine if such plans favor highly compensated employees over the rank-and-file. Recent IRS interpretations, however, have exempted the federal government, which seems unfair and further demonstrates the difficulties of this law. The employer is presumed guilty until proved otherwise, contrary to usual American justice which presumes innocence until proven guilty. Firms which voluntarily provide benefits must meet stringent requirements, while firms not offering such protection to their employees escape these administrative and costly burdens. In a time when public policy should encourage expansion of coverage, this legislation accomplishes the exact opposite.

To conduct the testing, employers must collect, analyze, maintain and update massive amounts of data. The data must then be subjected to a series of complicated eligibility and coverage tests. Penalties include taxing the health benefits of highly-compensated employees deemed in discriminatory excess. Employers who fail to disclose this information are subject to an excise tax on the amount of plan benefits that are deemed to be discriminatory.

As originally conceived, Section 89 was intended to encourage greater expansion of employee benefits, particularly health insurance, to more lower-paid and part-time workers. Yet, proponents of this provision now insist that repeal of Section 89 would constitute a loss in tax revenue and such a loss would have to be offset in compliance with Gramm-Rudman-Hollings targets. If all employers were able to comply with this legislation then no penalties would be collected. These apparent conflicting objectives further underscore the flawed nature of this statute.

The source of the potential revenue when a employer does not pass the tests also raises serious questions. Some employers may choose to increase the salary of the highly-compensated employees deemed in discriminatory excess, rather than change all benefit plans for the rank-and-file. Shifting these moneys from the corporate tax side to the individual side would result in less revenue given lower personal tax rates versus corporate rates, rather than achieve the policy objective of ensuring plans are nondiscriminatory.

No hearing record, or evidence other than anecdotal, exists to demonstrate that widespread plan discrimination existed to warrant special rules. No votes in either the House or Senate were taken on Section 89. Ironically, this new rule may well have the opposite effect and reduce health benefit options, reduce employer-provided dependent coverage and otherwise cause cutbacks in employer-sponsored coverage. If Congress is genuinely serious about discouraging discrimination, then hearings should be held to gather information on the extent and nature of suspected problems and types of possible solutions.

SECTION 89 AND SMALL BUSINESS: SUPERIOR TECHNICAL CERAMICS A CASE STUDY

The workforce of Superior Technical Ceramics includes 85 people, 15 of whom are salaried. Several of the latter are specialized engineers. Benefits are provided on a nondiscriminatory basis. The costs and hours spent in Section 89 compliance thus far for Superior Technical Ceramics is considerable, including:

- o 15 hours spent in three training courses at a cost of $1,500.
- o Purchase of software with a projected price of $10,000.
- o Legal fees to obtain disclaimer statements from 85 persons, 15 minutes each, at $150/hour or $1,750.
- o Preparation of the testing plan (with 14 separate sections) by an outside accounting firm at cost of $10,000.
- o Analysis of education benefit program to determine if this plan comes under Section 89; costs unknown.
- o Total known costs to date: $23,250.

Given the onerous and complex requirements of this law, our company has been forced to hire a full time personnel manager at a salary of $28,000 yearly plus 40 percent for fringe benefits, a cost which must be added to the above. While this manager will not spend full time on compliance, this law was the deciding factor in driving us to hire an additional staff person.

My company is committed to meeting its corporate responsibility by providing excellent medical, disability, maternity, life insurance and pension coverage to all its employees. A legal/regulatory system that frustrates this commitment is a sad commentary on America's free enterprise system and its basic societal values for a healthy and productive workforce.

OTHER EXAMPLES OF SMALL BUSINESS PROBLEMS WITH SECTION 89

Numerous companies have written NAM describing their experiences in attempting to comply with Section 89. Beisler-Weidmann Co., Inc., Belleville, New Jersey with 26 employees reported that its insurance company submitted a bill of $1000 plus $10 per employee to provide the company with an initial "snapshot" of the benefit program with future charges for retesting. Star Bronze Company, Alliance, Ohio, is a manufacturer with 50 employees which provides fully-company paid health insurance. The company has already spent hundreds of hours on research and document preparation at an estimated cost of $2,000 to $4,000. Inclinator Company of North America, Harrisburg, Pennsylvania, with 50 employees, will incur a cost of $1700 to $2500 plus an annual update fee to evaluate its life and health insurance benefits plans, according to estimates from its accounting firm. Many other examples are available and can be submitted for the record at the committee's request.

While these compliance costs may not seem excessive to one accustomed to dealing with larger businesses, the amount of time and money as a percentage of the entire business operation must be appreciated. The aggregate amount of time and money spent by the numerous small businesses nationwide is indeed considerable. Such a use of resources is wasted and could be better spent in enhancing employee benefit programs or investing in new plant and equipment.

HEALTH CARE COVERAGE AND SMALL BUSINESS

The Bureau of Labor Statistics in 1986 reported that 95 percent of medium to large firms provided health insurance. For small business, however, coverage is less widespread. A survey of 1,439 firms with fewer than 100 employees conducted by the National Federation of Independent Business (NFIB) in 1985, showed that 65 percent offered health benefits. This was an increase of 57 percent reported in 1979.

The NFIB findings are consistent with findings of a similar survey conducted by the U.S. Small Business Administration in 1986. In service and retail industries, slightly over one-half offered health benefits, while for manufacturing, 83 percent offered such coverage. Preliminary findings from a recent NAM survey of over 2,000 manufacturing firms show that of companies with 25 employees, 96.3 percent offered health benefits to workers and 94 percent also made coverage available to dependents.

While the manufacturing sector has scored better than the service sector, difficulties remain generally for small firms in obtaining affordable health insurance. These difficulties include less flexibility in selecting and designing health care plans. In negotiating with insurers, small firms have little clout and are poor underwriting risks. A December 1988 Wall Street Journal article reported that the typical premium increase for small business was close to 30 percent in 1988, with the reporting insurance agent indicating his own office of 40 employees had seen a 36 percent increase.

Rapidly increasing premiums lead small companies to switch carriers often, further increasing insurance rates. Small firms usually cannot afford the administrative costs of self-insurance nor are they able to benefit from self-insurance by spreading risks over a large employee base. Insured plans are also subject to state mandated benefit laws which raise the cost of insurance. Self-insured companies are exempted from these requirements through federal law.

Given these difficulties and the fact that there are an estimated 30 to 37 million persons without health insurance--a sizable portion of whom have some connection to the workforce--it seems ill-advised to discourage firms from offering employment-sponsored coverage. Rather, we need to pursue a national policy encouraging expanded coverage including minimizing regulation: for example--eliminating Section 89 and barriers to group purchasing of health insurance (multiple employer trusts); providing an ERISA exemption of state mandated benefit laws; and offering special tax incentives to very small and/or start-up businesses.

SECTION 89 MODIFICATION LEGISLATION AND REGULATORY GUIDANCE

Four Senate bills have been introduced to make changes to Section 89. In our view, S. 350 (Lott R-MS, 16 cosponsors) to repeal the statute represents the best approach to addressing this regulatory nightmare. H.R. 634 (LaFalce D-NY) introduced in the House on January 24, has over 279 cosponsors which clearly demonstrates strong support for this legislation.

Senator Pryor (D-AR) is to be commended for his efforts in seeking to respond to the problems of Section 89. S. 659 proposes a "simplified health arrangement." This standard, however, would benefit very few companies and would not alleviate problems for most small companies. We recognize that the requirement capping the cost of premiums is an effort to help low-wage workers, but it would discourage employee cost consciousness, shift additional cost to employers and restrict the flexibility of employers in designing cost-efficient benefit plans.

Employer attempts to offset this additional cost could lead to higher deductibles and out-of-pocket limits which would negatively affect low-income workers. S. 659 requires that at least 90 percent of all employees be eligible to participate. This provision does not indicate 90 percent of what--by product line? By location? This legislation, notwithstanding its relief on numbers of hours worked, provides no relief to the burdensome data gathering and testing requirements. Major compliance costs and administrative problems remain.

S. 595 (Domenici R-NM) is specifically targeted at small business relief, exempting companies under 20 employees. This proposal overlooks a significant segment of the small employer community. Relief on number of hours worked is helpful as is a two-year implementation delay. S. 595 leaves many problems unaddressed, however.

The Section 89 regulations issued by the IRS in March are complex and offer little in the way of clarification. The regulations were long overdue and omitted several important issues yet to be clarified, including separate lines of businesses, group term life insurance, former employees, excludable employees, and leased employees. The Office of Management and Budget (OMB) estimates that 9 million man hours or an average of ten hours per firm are needed to comply with Section 89. This seems understated given the time needed to collect data, read and understand the 200 pages of regulations and make the necessary calculations.

Small businesses, in particular, do not have the resources to accommodate this burden. Special exemptions for small business are not the answer, however. All businesses must account for increased costs spent on regulatory compliance and they can be expected to pass along these costs to their customers, or suppliers, in finished products or in services. Added costs for regulatory compliance make American business less competitive, which must be avoided if we are to retain our economic leadership in the world today.

CONCLUSION

Section 89 is a major barrier to the expansion of employer-sponsored health coverage among small businesses and will lead some firms to significantly cut back existing coverage and, in some cases, drop benefits altogether. Since coverage by small business is already lower, it seems unwise to further impede expansion. Rather, government should consciously take steps to reverse the impact of this legislation. We urge repeal of Section 89 and would be pleased to work with you on this important effort.

Senator **Boschwitz**. Yes. Please make them part of the record. We will keep the record open for a few days and then we will see that the entirety of the record is made available also to the Treasury Department so they get a better sense of it, and that would make it a more meaningful record.

The fact that we have had people such as yourself and not just a bunch of lawyers or professional heads of associations here this morning I think has strengthened the testimony because those folks are expected to do so.

And the fact that people have testified by just not reading prepared testimony has also, in my judgment, strengthened the testimony.

The letters that our friend from Minnesota brought also will be helpful and those case studies that you have.

Ms. **Church**. Senator, could I say one more thing which is I hope that you will appreciate that we were very impressed with the number of Senators that came out this morning and even though they had a very tight schedule, and your patience was wonderful.

Senator **Boschwitz**. Thanks very much. The hearing on that note will be concluded.

[Whereupon, at 12:52 p.m., the Committee adjourned, subject to the call of the Chair.]

APPENDIX

ASSOCIATION FOR ADVANCED LIFE UNDERWRITING

DAVID J. STERTZER • *Executive Director*
1922 F Street, N.W., Washington, D.C. 20006-4390 • 202/331-6081

A CONFERENCE OF THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

Counsel
LEONARD L. SILVERSTEIN
GERALD H. SHERMAN

Associate Counsel
STUART M. LEWIS
1776 K Street, N.W.
Washington, D.C. 20006

1989 - 1990 OFFICERS
AND DIRECTORS

OFFICERS

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WILLIAM V. REGAN, III, CLU
New York Life
100 Pine Street
Suite 1675
San Francisco, California 94111

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Massachusetts Mutual
P.O. Box 8
Newtown, Pennsylvania 18940

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P.O. Box 827
Clarksville, Tennessee 37041-0827

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Provident Mutual
3825 Piedmont Road, N.E.
Building 6, Suite 415
Atlanta, Georgia 30305

Secretary-Treasurer
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8989 North Port Washington Road
Suite 275
P.O. Box 17986
Milwaukee, Wisconsin 53217

DIRECTORS

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901 Dove Street
Suite 155
Newport Beach, California 92660

SAUL F. FEINGOLD, CLU, ChFC
Worcester Center
1880 Mechanics Tower
Worcester, Massachusetts 01608

READ F. GOODE, CLU, ChFC
P.O. Box 306
Midlothian, Virginia 23113

EDWARD B. "TED" KIBBLE, CLU
1000 Plaza 600 Building
Seattle, Washington 98101

EDWARD K. LEATON, CLU, ChFC
The New England
101 Park Avenue
28th Floor
New York, New York 10178

H. STANLEY MANSFIELD, JR., CLU
Northwestern Mutual
885 Third Avenue
30th Floor
New York, New York 10017

ROBERT W. VERHILLE, CLU
Kansas City Life
P.O. Box 809
Marion, Iowa 52302

March 31, 1989

The Honorable Dale Bumpers
U.S. Senate
Washington, DC 20510

Dear Senator:

The Association for Advanced Life Underwriting (AALU) commends Senator Pryor for his effort to simplify and rationalize the nondiscrimination rules contained in IRC Section 89. While Senator Pryor's bill, S. 654, could be strengthened in some places, it does solve a number of serious problems and thus represents an encouraging beginning of the effort to reform Section 89.

The 1,500 advanced life underwriters represented by AALU join their over 135,000 colleagues represented by the National Association of Life Underwriters (NALU) in supporting Senator Pryor's work to make Section 89 workable.

Sincerely,

Bill Regan

William V. Regan, III, CLU
President

aspa
Managing Human Resources

STATEMENT OF

THE AMERICAN SOCIETY FOR PERSONNEL ADMINISTRATION

SUBMITTED TO

THE SMALL BUSINESS COMMITTEE
OF THE
UNITED STATES SENATE

HEARING ON SECTION 89 OF THE INTERNAL REVENUE CODE
APRIL 13, 1989

American Society For Personnel Administration
National Headquarters • 606 N. Washington Street • Alexandria, Virginia 22314 • Phone: 703/548-3440

The American Society for Personnel Administration (ASPA) is the world's largest professional society devoted exclusively to excellence in human resource management. The Society's membership has grown to more than 40,000 since its founding in 1948. ASPA represents individuals employed by companies which collectively employ more than 41 million people and includes managers from a cross-section of American business -- from large corporations to smaller family operations -- as well as governmental entities and not-for-profit firms.

On the front lines as practitioners, innovators, managers and decision-makers, human resource professionals are challenged to balance their companies' need for administrative cost-effectiveness with their employees' desire for fair and comprehensive welfare benefit plans. ASPA is in a unique position to provide practical guidance on employee benefit issues, and we encourage employers to offer competitive and diverse benefits packages. We are very concerned over the effect of Section 89 on employee benefit plans, and we commend the members of the Senate Small Business Committee for addressing this issue through today's hearing.

ASPA understands the Congressional intent behind Section 89 to expand coverage of employee benefits. However, as representatives of practitioners who deal with employee benefit plans every day, we assure the Committee that, in trying to remedy this perceived problem, Congress has created a law that is so complex, and imposes such substantial administrative burdens on employers, that it is a very effective impediment to employers who wish to expand the diversity and scope of their employee benefit coverage.

The much anticipated Section 89 regulations, which were so difficult to draft that they were issued almost three years after the law was passed, provide little relief from, and even less clarification of, a law which took effect on January 1 of this year. Section 89 is driving plan sponsors to either simplify their plans by reducing health benefit options and cutting back on subsidized family health coverage, or simply eliminating health coverage benefits for employees. For this reason, we believe that repeal of Section 89 is the only available option for Congress to relieve employers of its unrealistic administrative burdens.

Although, Section 89's regulations were finally published on March 7, few plan sponsors are any closer to a clear understanding of exactly what the new law entails. The regulations, as the IRS is quick to point out, do contain transitional relief for many of the law's less complex qualification rules, and they even relax compliance standards for the complicated non-discrimination tests in 1989. But the regulations do little to reduce the law's burdensome data collection and testing requirements.

In a few cases the IRS uses the transition rules contained in the regulations to actually make the testing requirements more complicated, and, in at least one case, even seems to exceed its statutory authority. For example, the regulations appear to require the 50% eligibility test as a prerequisite to using the 80% alternative coverage test, a provision not included in the original statute or its legislative history.

While the IRS provided some relief to a few employers of over 5,000 employees, it gave no such assistance to the small business community, which, because it lacks the necessary resources, will have a more difficult time with compliance. It is interesting to note that this particular relief provision might conveniently apply to the Federal government, thereby exempting it from testing. Additionally, the regulations do not include much-needed guidance on group term life insurance plans, excludable employees, leased employees, separate lines of business, and multi-employer plans.

To comply with Section 89's regulations, employers must first establish that their plans conform to Section 89's qualification standards. They must then gather data and conduct the complicated statistical tests for every coverage option available to any employee. This means that single and family coverage options, all health and other applicable options under flexible benefit plans, and all employee contribution and coverage levels must be treated as individual plans. Applying actuarial standards, the employer must determine the value of each plan, as well as the number of employees eligible for testing and the number of employees who are "highly compensated". The employer is even required to obtain sworn affidavits, submitted under penalties of perjury, from employees regarding their coverage under other plans and their marital and dependent status. The employee relations impact of this provision is deplorable.

To avoid additional taxes, the employer must prove that each separate plan option can pass statistical tests requiring that certain percentages of "non-highly compensated" employees receive acceptably high values of benefits as compared to their "highly compensated" colleagues. Unbelievably, a plan can be deemed discriminatory if a proportion of lower paid employees choose not to participate, even if all employees are offered equal access to the plan. This has a tremendous impact on smaller employers, since any individual employee represents a large percentage of their workforce.

What does all of this mean to employers? One ASPA member has told us that his company will face first year compliance costs of $3,000 for in-house staff time and $20-25,000 for outside consultant fees to assist in actuarial valuation and statistical evaluation of its plans. It will face second year costs of $3,000 for software and an additional $3,000 for training an in-house expert on Section 89.

What does this mean to its employees? In this case, Section 89 is forcing his company to delay, perhaps indefinitely, the implementation of a planned employee flexible benefit plan.

An ASPA member of a smaller company was not able to find any outside consultant assistance on Section 89 for less than $7,500. Yet another's company will be forced to scrap its diversified benefits structure and return to its pre-1985 single health plan option for all its employees.

Consultants have referred to Section 89 as a regulatory "mine field". There are so many potential pitfalls and penalties contained in the complicated regulations for an employer who offers anything other than the most basic health benefits package to its employees that some consultants are advising their clients, especially small business owners, to reduce or terminate health care coverage to their employees. It is simply not worth the risk, and is the easiest and least expensive Section 89 compliance method. To make matters worse, Section 89 is entering the picture at a time when health care costs are rapidly escalating, with costs to employers increasing 30%, 40% or even

50% per year.

Many employers are angry that they will have to spend considerable sums of money merely to prove what they knew all along -- that their plans are not discriminatory. Others are angry that they are being penalized for offering extensive, diversified benefit packages which best meet their employees' needs.

The end result of Section 89 is the exact opposite of Congressional intent: employers will reduce or eliminate health care coverage to employees. At a time when Congress is supposedly so concerned for those who lack adequate health insurance that it is even considering a mandate on employers to provide such coverage, it is simply not sound social policy to pass a law which is so difficult to administer that it could effectively reduce the degree of employer health care coverage offered today and in the future. Now that the unworkable nature of this law is apparent, we are confident that Congress will recognize this error, and repeal it forthright.

Legislation to reform Section 89 has now been introduced in both the House of Representatives and the Senate. We would like to take this opportunity to present the following ideas for how Section 89 could have been made less burdensome to employers:

- Congress could have included a more inclusive safe harbor for plans meeting predetermined minimum employee eligibility levels and maximum levels of employee contributions as a percentage of total coverage cost.

- Congress could have excluded collectively bargained plans from testing.

- Passage of Section 125 tests could have been made a safe harbor for Section 89 purposes, instead of requiring separate tests for every coverage option available under those types of plans.

- Employers could have been allowed to consider employee-only and family coverage options under the same benefit structure as the same plan, and Congress could have eliminated the sworn statement requirement.

- The designation of relatively minor benefits, such as accidental death and dismemberment and business travel accident benefits, as de minimis fringe benefits which would not require testing could have considerably reduced testing obligations.

- Congress could have designated a higher threshold for part time workers. It is an unfortunate fact of life that

> setting a low part-time threshold does not protect the part-time worker; it merely discourages the employer from maintaining or creating positions which exceed the minimum hours-per-week definition.

Section 89 has clearly failed to encourage employers to broaden benefit coverage among their employees, and instead will have a deleterious effect on employee benefits. We thank the Committee for examining this issue, and we are hopeful that Congress will address this problematic legislation in the near future.

Statement of

The Associated General Contractors of America

Presented to the

Committee on Small Business

of the

United States Senate

on the Subject of

The Section 89 Nondiscrimination Requirements

April 13, 1989

AGC is:

- **More than 32,500 firms including 8,000 of America's leading general contracting firms responsible for the employment of 3,500,000-plus employees;**
- **104 chapters nationwide;**
- **More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities.**

The Associated General Contractors of America is a construction trade association representing more than 32,500 firms, including 8,000 of America's leading general contracting companies, which are responsible for the employment of more than 3,500,000 individuals. These member contractors perform more than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities. Eighty-five percent of AGC's membership has gross receipts of less than $10 million annually; ninety percent qualify under the Small Business Administration's definition of a small business. AGC appreciates this opportunity to comment on the new rules under Section 89 relating to employee benefit plans.

Congress clearly recognizes the serious problems Section 89 poses for every segment of American industry. Sen. Steve Symms of Idaho has introduced legislation to delay implementation of Section 89 for one year. Sen. David Pryor of Arkansas has introduced legislation to simplify the bill. Additionally, the Senate, on April 12, agreed overwhelmingly to a sense of the Senate amendment that the House should immediately pass and report to the Senate a bill to repeal or reform Section 89. On the House side, Rep. LaFalce's bill to repeal Section 89 has over 280 co-sponsors, and the House Ways and Means Committee is preparing to amend Section 89.

We urge that in considering AGC's comments, Congress keep in mind the unique nature of the construction industry, as follows:

- The construction industry produces a unique item with every building, facility or highway constructed. Each site varies; conditions for construction vary every day.

- The construction industry is hundreds of thousands of jobsites. Unlike any other industry, once a particular project is finished, the construction work force moves on.

- The construction industry has a transient workforce. Once a particular project is finished, construction workers must move to other sites and usually to new employers.

- A construction worker may leave and come back to the same employer several times during the course of the year. Employee benefit plans have evolved to suit the needs of that transient workforce.

AGC strongly supports and endorses proposals that would delay implementation of Section 89 until the many serious problems already identified with the statute can be addressed. If these issues cannot be resolved, AGC supports repeal of the 1986 changes. The new rules do not further Congress' goal of encouraging broader coverage of nonhighly compensated workers. Instead, their complexity and administrative problems force employers to reduce the number of options they offer to employees.

In 1986, Congress added new Section 89, setting up comprehensive nondiscrimination requirements for employee health and welfare benefit plans. The stated goal was to encourage expanding health care coverage to more nonhighly compensated employees. The extreme complexity of the tests, the costly administrative burden they impose and the failure of the Internal Revenue Service to provide timely essential guidance is instead pushing small businesses to eliminating health care or reducing their health care coverage.

Congress added the new rules as part of the Tax Reform Act of 1986. Originally, the new law was to become effective for plan years beginning after December 31, 1987, if the IRS issued guidance. In the absence of IRS guidance, the new rules were then to become effective for the earlier of plan years beginning at lease three months after the regulations were issued or plan years beginning after December 31, 1988. As part of the 1988 tax act, Congress directed the IRS to issue guidance by November 15, 1988. Congress also legislatively prescribed some temporary rules to fill the void.

The IRS did not issue guidance until March 7, 1989. The proposed regulations did not address multiemployer plan issues, lines of business or the valuation question, which is central to the entire concept of Section 89. The regulations that did come out increased the complexity of an already dense statute. Although the regulations postponed several important sections and added transition rules, the gains from those changes are outweighed by the additional complexities added by the proposed regulations.

The lack of timely guidance from the IRS is the most acute, though not the only, problem facing employers trying to comply with Sec. 89. IRS and Treasury representatives have said that there is sufficient guidance elsewhere in its releases for employers to comply with the new law. If that were correct, then the IRS and Treasury should have found it relatively simple to provide guidance. Instead, there was no official guidance for more than 2 1/2 years after enactment.

If the IRS and Treasury cannot provide guidance, then employers should not be expected to make up the deficiency. Employers making a good-faith effort to comply may find their determinations overturned on audit. Steep penalties would follow for failure to comply with Section 89.

In addition to the lack of timely guidance on the new law, AGC has identified several specific problem areas.

Some of the most acute problems center around the plan qualification requirements. Employers must first satisfy a five-part qualification test for employee benefit plans established under any one of nine different Internal Revenue Code sections. These include group health and accident plans, group term life insurance plans, group legal services plans, educational assistance plans, dependent care assistance plans, tuition reduction plans, cafeteria plans, Sec. 505 plans (including VEBAs) and employee fringe benefits plans.

For each of these plans, the plan must be in writing, the employees' rights must be legally enforceable, employees must be given reasonable notification of benefits, the plan must be established for the exclusive benefit of the employees, spouses and dependents, and the plan must be established with the intention of maintaining it for an indefinite period of time.

These requirements do not sound that difficult to meet. On closer examination, a number of problems appear.

For example, after the 1988 act, the written material describing the plan may be a group of documents, as long as each plan is adequately described in writing. The proposed regulations contain a long list of material terms that must be included in the description. There must be one document listing other documents that must be specifically incorporated by reference.

Those plan documents must be legally enforceable. The employees' rights must be ascertainable from the documents, so that legal remedies can be pursued based on the documents. So those documents must be carefully prepared with that in mind.

Employees must receive reasonable notification of their benefits under the plan. What constitutes reasonable notification? The answer seems to be that every employee must be notified of every benefit under every plan, in order to avoid Section 89 penalties. Notification may not be limited to employees who are eligible for a particular benefit. Employees who may become eligible in the future must also be notified.

The plans must be established for the exclusive benefit of employees, their spouses and dependents. There may be a hidden trap in that provision, because of the interaction with the leased employee rules. In 1982, Congress concluded that employees of a "leasing organization" were to be treated as employees of the organization to which they provided services for retirement plan purposes in a number of situations. Congress extended this rule to plans covered by Section 89 as part of the 1986 tax act changes. The IRS published proposed regulations that broadly define a leasing organization far beyond Congress' intent. Some IRS representatives interpret the employee leasing rules to cover the general contractor-subcontractor relationship On a construction site, one general contractor works with multiple subcontractor companies. For example, on a commercial building site, the general contractor can have up to 75 subcontracting companies on that one site during the life of the contract. The data gathering requirements alone are monumental, for all the different subcontractors.

If the subcontractor's employees are to be treated as the general contractor's employees for Section 89 purposes, then the subcontractor's employees will have to be notified of the general contractor's plans. If the subcontractor's employees are not to be treated as the general contractor's employees, then including them may cause the plan to fail Sec. 89 because it is not for the exclusive benefit of employees. The general contractor may be caught in an impossible situation.

If a general contractor is too broadly inclusive, he may fail that part of the test. If he isn't inclusive enough, he will fail a different part of Section 89. If a construction contractor doesn't provide notice of his plans to his subcontractors, he may fail the qualification requirements if the IRS later determines he should have done so.

The issue is not academic. It is an issue the construction industry is struggling to resolve, because the penalties for noncompliance in this area are so severe.

Failure to meet even one of the qualification requirements would mean that all employees, from the lowest-paid to the highest-paid, must recognize additional income and pay taxes. For example, a general contractor will have many subcontractors for a specific project. At least some IRS representatives have indicated that the employees of the subcontractor would be treated as employees of the general contractor for purposes of Section 89. If the general contractor hasn't given the subcontractor's employees reasonable notification of the general contractor's health plans, all employees, both the subcontractors' employees and the general contractor's employees, will then be faced with a large, unexpected and unpredictable tax bill. A number of them might even be faced with penalties for inadequate withholding. This is before any of the second part of Section 89 is even considered.

The qualification requirements are only the first and allegedly the easiest step. Employers must then satisfy either a two-part actual coverage test or a four-part eligibility and benefits test for their group health and accident plans and group term life insurance plans. If those tests aren't satisfied, highly compensated employees will recognize income on the "discriminatory" excess benefits.

These are a number of problems with this part of Section 89. The 1986 act set percentages that had to be met to satisfy Section 89's requirements. For small businesses, those percentages may be extremely difficult to meet. The loss or addition of just one employee may be enough to disqualify a plan.

The question of valuation of benefits is central to the entire Section 89 process. Employers have been struggling to define that concept until Congress legislatively prescribed some temporary special valuation rules. The absence of guidance on this most important issue would by itself be enough reason to postpone implementation of Section 89. Even the temporary rules do not resolve problems faced by employers.

The costs of compiling the initial information with which to begin Section 89 compliance are staggering. Employers must accumulate a significant amount of data regarding each employee and each option under a plan to prove compliance. The information required includes an employee's date of birth, the date of hire, marital status, employment status, number of dependents, annual compensation for this year and the preceding year, the number of hours normally worked in a week, the number of months normally worked in a year, whether employees are eligible members of a collective bargaining unit, benefit options an employee is eligible for, benefit options the employee actually participates in and other coverage on employees, spouses and dependents.

For example, each option under a plan must be valued separately. That means that for each option, each employee must be ranked twice - once under this year's salary and once under last year's - to determine how many highly compensated employees participate in that option. The confusion of an employer faced with calculating all options for all employees approaches chaos.

The employees of the subcontractors can be treated as employees of the general contractor for Section 89 purposes. The penalties for noncompliance would then fall on the general contractor and on all the employees of the subcontractor. The subcontractors are not required to supply any information to the general contractor or the employees on the job-sites. The subcontractors, because they are treated as the leasing organization, are not compelled to provide information for compliance testing to the general contractor. The general contractor may supply Section 89 information to the subcontractors, but there is no mechanism for ensuring that the actual employer, that is the subcontractors, supply the necessary information to the on-site employees.

The employment relationship in the construction industry is unique for several reasons. Unlike any other industry, construction companies are faced with constantly shifting job sites and constantly shifting work forces. Given the phased nature of the construction process, the work force changes as the job progresses. For example, on a commercial building, the electricians may come in, work on several floors, move to another job site to do electrical work there, then come back and work on additional floors, and so on until the contract is finished.

Construction workers do not have the choice of staying at a project once a project is completed. Once a particular project is completed at a site, that site will never need construction workers again. That is why the construction industry has an annual employee turnover rate of over 300%. Employees who wish to continue working must move onto another site and frequently another employer to stay employed.

This creates tremendous uncertainty as to whether a plan will stay qualified. With turnover and periodic cyclical and seasonal unemployment, plan administrators will never be certain that a plan will pass. The addition or subtraction of just a few employees on a job site near the end of the year may cause a plan to become disqualified for the entire year unexpectedly, particularly for smaller contractors.

A construction contractor selects a test day well in advance in accordance with the Code. That day will be a good-faith selection during what is normally a busy season for construction. When the test day arrives, it may not fairly reflect the general work force normally employed by the contractor. The construction contractor may have just finished a project, in which case there would be only a minimal staff. The contractor may have just begun a project in which case then are large numbers of workers on-site. It may rain or storm on the test day, so that no hourly workers are employed. There may have been a storm recently, so that extra workers are working on the test day to make up lost time. In the construction industry, these are actual events beyond the control of the contractor. They cannot be predicted in advance. Yet the IRS may determine that the selection of the test was not in good faith.

The health plan arrangements for construction workers were an attempt to solve the problem of providing fringe benefits to workers who wouldn't satisfy the normal participation requirements. Generally, the contributions reflect the short-term nature of their employment.

The existing Section 89 rules for collectively bargained employees exclude few if any union employees. Any employee covered by the same type of plan must be included in the nondiscrimination testing process. For example, union employees covered by a union health plan must be included in testing the employer's nonunion health plan. However, excluding those employees may in some cases cause a plan to fail Section 89 even though it covers large numbers of nonhighly compensated employees.

Collecting data on collectively bargained employees can be virtually impossible for employers who contribute to such plans. It will be difficult for those employers to determine which employees are highly compensated. The employer knows only the amount it paid that employee, but not the employee's overall compensation. There are no mechanisms in the statute to compel plan administrators to share the necessary information.

Even if the plan shares the information, the employer cannot correct a discriminatory plan. The employer negotiates for a cents-per-hour contribution. The plan administrator determines what options are offered and how contributions are divided among options.

It is typical in the construction industry generally and in multiemployer plan situations that there are dramatic fluctuations in the workforce from employer to employer from day to day. The credibility of a test day selected in good faith could be called into question because of job movement in the labor force. Test days are selected in advance, and the individual contributing employer may or may not have members of a particular bargaining unit working on that day.

Section 89 does not address the interactions with the Davis-Bacon Act. That Act requires employers to pay prevailing wages and fringe benefits to hourly construction workers. The Labor Department prescribes the amounts to be paid for each class of worker. Section 89 may force employers to pay taxes on amounts another federal statute obligates them to pay.

The tax-favored treatment of employer-provided employee benefits furthers an important social goal of expanding health care coverage. The new Section 89 provisions will have the opposite effect. The increased complexity, compliance costs, and the expensive necessary testing process will push employers to streamline their plans, reduce the number of options offered and cut back on health care coverage. Implementation of the statute needs to be postponed until it can be reexamined. If the issues cannot be resolved, Section 89 as it now exists should be repealed.

AGC believes that Congress' goal of covering nonhighly compensated employees to an extent comparable to the coverage of highly compensated employees can be achieved in a much less complex fashion.

The drafters of Section 89 attempted to resolve every conceivable inequity and future loophole, creating ever more complex rules. Section 89 was aimed at controlling benefit discrimination between highly compensated and nonhighly compensated employees. The drafters attempted to control the distribution of benefits within the nonhighly compensated group. From that goal comes most of Section 89's complexity. Yet that goal goes far beyond rules in the pension area.

AGC would suggest that a design-based test should be used to restrain benefit discrimination between the highly compensated employees as a group and the nonhighly compensated employees as a group. A 70% eligibility test should apply by treating as covered by any plan for which they are reasonably eligible. The most common barrier to eligibility is the cost of employee contributions. A plan available at reasonable cost would be treated as reasonably available. Reasonable cost could be defined as a percentage of employer costs, a flat dollar amount or a percent of pay.

The testing process should concentrate on cost, not value. The value of a benefit is so difficult to calculate that the IRS has yet to issue rules. The market will ensure that cost fairly reflects value. Each option would not need to be tested separately, as options would be reflected in the cost. Discrimination would then be measured as cost disproportionate to compensation.

Multiemployer plans should be excluded from the qualification rules and penalties for individual contributing employers. The plan administrator should be responsible for satisfying the rules and for sanctions involved in failing to carry out that task.

Section 89 rules should permit an employer to elect to treat any employee included in a collective bargaining agreement which has engaged in good faith bargaining as receiving benefits under the plan or plans covering highly compensated employees. Merely excluding union employees from coverage is not sufficient, because some employers may need to count coverage of those employees. It may also be necessary to deem all collectively-bargained employees to be nonhighly compensated.

The exclusion for part-time employees should be expanded to exclude employees working less than 28 hours a week. "Leased" employees should be excluded from the testing process until the problems in that area can be resolved. Interactions with other federal benefit statutes, notably the Davis-Bacon Act, should be resolved. The penalties for Section 89 should be reexamined.

AGC appreciates this opportunity to discuss its concerns and looks forward to working with Congress to resolve these problems.

NATIONAL
COUNCIL OF
AGRICULTURAL
EMPLOYERS

Statement of

the National Council of Agricultural Employers

Submitted to

the Small Business Committee

of the

United States Senate

Hearing on Section 89 of the Internal Revenue Code

April 13, 1989

499 South Capitol Street, S.W. • Suite 411 • Washington, D.C. 20003 • (202) 488-1100

The National Council of Agricultural Employers (NCAE) appreciates this opportunity to comment on the problems and concerns agricultural employers have with respect to Section 89 of the Internal Revenue Code. The Senate Small Business Committee is to be commended for hearing the cries of small and large businesses alike and taking these first steps to repeal or significantly modify Section 89.

NCAE is an association of growers, cooperatives and others involved in labor-intensive agriculture. Our members hire approximately 75 percent of the U.S. farm workforce. Many of the agricultural operations represented by NCAE are considered small businesses. All of our members are finding it difficult, costly and time-consuming to comply with the provisions of Section 89.

The intent of the authors of Section 89 was to broaden health and life insurance coverage for non-highly compensated employees. The extraordinarily complex provisions of the law, however, have imposed difficult and expensive burdens on agricultural employers, some of whom have cancelled or significantly cut back on benefits out of the frustration of attempting to comply with Section 89. This end result is hurting rather than helping employees.

NCAE, therefore, is strongly in support of repeal of Section 89. Proposals to amend its provisions are now before the Senate. We believe these proposals to retain the most beneficial elements of Section 89 should only be considered after repeal of the law.

It has been suggested the repeal of Section 89 will create a revenue loss for the federal government. If the intent of Congress was to broaden benefits coverage for non-highly compensated employees, Section 89 would be revenue negative to the degree that it compels companies to change plans. Where it does not do that, many orgaizations "gross up" their highly compensated employees. This transfers money from taxable corporate profits to deductible wage payments and offsets any additional taxes paid by individual highly compensated employees. Beyond this flaw, it is so burdensome, complex and costly to administer Section 89 that it cannot be justified as a tax revenue generator under any cost/benefits analysis.

Specific NCAE objections to Section 89 include the following:

1. Section 89 uses a meat-axe, one-size-fits-all theory of benefits which discourages innovation in cafeteria plans and which fails to recognize the diverse needs of different segments of our work force. For example, one member of NCAE offers employees a choice of 3 different medical plans. The fact that non-highly compensated employees prefer one plan over another fails the non-favored plans, even though employees have equal access to any plan. Another employer with only one plan learned that failure of non-highly compensated employees to elect dependent coverage can

fail their plan.

2. Preliminary calculations by NCAE's Employee Benefits Committee suggest that Section 89 is costing employers five times any potential tax benefit (to the government) to administer.
3. The most generous and creative employers end up being penalized for the variety of choices given to employees, while employers who offer no help are unaffected.
4. Section 89 has created an atmosphere where employers who do not currently offer benefits will be unwilling to do so.
5. Section 89's requirement for extensive statistical testing of plans creates an unreasonable administrative and financial burden that outweighs any benefit derived.
6. The inclusion of leased employees (6 months or longer) as persons to be considered as employees for discrimination testing creates a difficult and expensive tracking problem for employers.
7. Section 89 excludes from testing persons with less than 6 months' annual service. These individuals, however, are not excluded if an employer provides them with any coverage at all. This provision penalizes the most considerate employers and hurts seasonal employees, who may lose coverage as these rules are applied.

NCAE recognizes that those who proposed this law did of altruistic motives. NCAE recognizes that there may be some merit to requiring qualification standards for benefit plans. The approach taken by Section 89, however, is so flawed that the statute needs to be repealed. The few provisions that are meritorious could then be considered by Congress with the benefit of committee hearings to consider the impact on businesses and labor before enactment.

One last point needs to be made:

Over the last forty years, there has been a tremendous growth in the variety and cost of benefits voluntarily provided by this nation's employers. Most would agree that this development has provided the average person with an unprecedented level of security for both their working and retirement years. Benefits are a long term commitment by employers, and require a stable, predictable regulatory and tax atmosphere. That atmosphere is being eroded by well-meaning but vexatious legislation. In such a climate, only the largest and the strongest employers will be comfortable introducing or in somes cases, even maintaining benefit programs where their obligations may be drastically altered by government fiat in the future.

Legislation such as that which created Section 89's complex and costly impact on employers tends to punish the most innovative, the most generous and most responsible employers.

This law hits hard at innovative programs like cafeteria plans which offer creative solutions to day care and other concerns. And the numbing morass of statistical testing creates an additional drag on the productivity and efficiency of American business.

We would respectfully suggest that Congress could help this nation regain a preeminent position in the global economy by redirecting their efforts and attention to simplifying and streamlining the regulatory burden that now exists, not in adding to it. In industries which are subject to international competition, cost increases cannot be passed along to consumers. Large employers must increasingly consider whether to move production offshore in order to remain competitive. Smaller employers have no options.

All of us recognize that regulations are necessary in many areas of business. What we are having difficulty accepting is the notion that every nuance of employment relationships requires a corresponding statute.

city of
bloomington, minnesota
Municipal Building • 2215 West Old Shakopee Road • Bloomington, Minnesota 55431-3096 • (612) 881-5811

February 28, 1989

Mr. Peter Coyle
Senator Rudy Boschwitz' Office
SH-506
Washington, D. C. 20510

Dear Mr. Coyle:

Thank you for speaking with me by telephone last week. You will recall that I expressed some of the concerns that the City has in regard to compliance with Section 89.

Enclosed please find a letter written to Senator Boschwitz dated August 4, 1988 detailing some of the concerns that the City has for compliance with the law. The letter is brief and identifies only some of the City's objections and, within the next few days, some Bloomington public officials will be attending the National League of Cities Conference in Washington. The City Manager and some Council members will probably be meeting with you and the Senator, if he is available, to express their concerns regarding Section 89.

If you need additional information or clarification, please do not hesitate to call me.

Kent T. Michaelson
Director of Personnel
and Labor Relations

KTM/jt
Enclosure: 1

AN AFFIRMATIVE ACTION/EQUAL OPPORTUNITY EMPLOYER
Telecommunications Device for the Deaf: (612) 887-9677

city of
bloomington, minnesota
Municipal Building • 2215 West Old Shakopee Road • Bloomington, Minnesota 55431-3096 • (612) 881-5811

August 4, 1988

Senator Rudy Boschwitz
SH-506
Washington D. C. 20510

Re: Section 89 Compliance

Dear Senator Boschwitz:

The Tax Reform Act of 1986 (P.L. 99:514) was signed into law on October 22, 1986 and established a new Internal Revenue Service Code Section 89 governing employee benefit plans. The City of Bloomington was recently informed that the law and Section 89 does include political subdivisions and we have been instructed that the City's compliance is mandated. The purpose of this letter is to provide you with a brief description of how Section 89 impacts this local unit of government and, from a practitioners point of view, to offer suggested changes to make this law more workable. I have learned that the Congress is considering technical amendments to the Tax Reform Act and we would appreciate your consideration of the City's comments when the Congress considers making changes to the law.

Section 89 requires employers to meet qualifying standards that are applied to welfare benefit plans. The qualification standards include five specific areas:

1. The plan must be in writing.
2. The employee's rights under the plan must be enforceable.
3. Employees must be provided with reasonable notification of benefits available.
4. The plan must be maintained for the exclusive benefit of the employees.
5. The plan must be established with the intention of maintaining it indefinitely.

The City of Bloomington, as a public employer, does provide a variety of health and welfare plans. The City will be able to obtain the necessary documents for compliance with the above qualification standards.

Section 89 also requires a series of non-discrimination tests. Non-discrimination tests are based on data that identifies the composition of the workforce and the distribution of the workforce into the various benefit plans. Obtaining data and conducting the non-discrimination tests is extremely time-consuming and many employers, including the City, are not currently equipped to obtain the base data.

The various non-discrimination tests include:

1. The 80% coverage test
2. The 50% eligibility test
3. The 90%-50% eligibility test
4. The alternative eligibility percentage test
5. The non-discrimination facts and circumstances test

The basis of the non-discrimination test is what is termed "highly-compensated individuals". The threshold for an employee to be a highly-compensated individual is compensation received in excess of $50,000 per year. Bloomington records indicate that for calendar year 1987, 18 employees received compensation in excess of $50,000. Eight of the 18 employees are Bloomington police officers. The average normal base wage for police officers is $33,500 per year and, when combined with overtime worked, several officers have increased their wages above the $50,000 threshold. One officer became the 6th highest paid employee of the City by working a considerable amount of overtime hours. The highest paid employee of the City is the City Manager with a gross salary for 1987 of $76,736. It is estimated that for 1988 an additional 10 employees will exceed the $50,000 per year threshold and 7 of these employees are police officers.

The purpose of providing this information is to urge you and other members of the Congress to reconsider the $50,000 per year salary level. It does not seem unreasonable that the definition of "highly-compensated individuals" should be changed to reflect some much larger amount.

For more than thirty years Bloomington has offered various health and welfare plans to its employees. These health and welfare plans are available, at a minimum, to all regular fulltime employees and employees may choose any plan offered by the City. The City's contribution for these plans are nearly identical for all employee groups, union and non-union employees alike. It does seem reasonable that, in view of the practice of public employers in providing health and welfare benefits, Section 89 should not apply to such units of government. A technical amendment to the Tax Reform Act of 1986 could be the exemption of governmental units for the complex and onerous requirements of Section 89.

The penalties for non-compliance of Section 89 are severe, including the taxation of health and welfare benefits for public employees. Public sector workers, as a general rule, are not highly compensated individuals and requiring local units of government to comply with Section 89 does not appear to be either fair or reasonable to public employees.

We would appreciate your consideration to these comments and concerns when reviewing the upcoming legislation.

Respectfully,

Kent T. Michaelsen
Director of Personnel
and Labor Relations

KTM/jc

CMI Central Medical Incorporated

23 February 1989,

Senator Rudy Boschwitz,
Senate Small Business Committee,
c/o Peter Coyle,
Washington, D.C., 20510.

Dear Senator Boschwitz,

I am General Manager for a Small Medical company in Minneapolis and am increasingly concerned about the Federal regulations that are impacting my company. It appears that many of the regulations being passed have little concern for the small business who struggles to be competitive in the marketplace. I am forced to spend more and more of my time complying to regulations taking away time that should be spent developing business to stay alive.

The new Section 89 is a good case in point. About six months ago I heard that this regulation was coming and that it was going to be complex. Since that time my file has grown to nearly three inches with information from lawyers, accountants, insurance companies and from firms that are being formed to help employers comply.

I feel that by in large the owners of this company are honest, fair, and treat their employees well. With the advent of Section 89 we are placed in a position of having to prove that these owners are not taking advantage of their employees or the Federal Government. To prove this my business will loose valuable time and spend precious funds to comply to a regulation that may or may not be enforceable or if it is cost me, as a taxpayer millions of dollars to feed an enforcing bureaucracy.

Last year we were asked to comply to the form I-9, Employment Eligibility. This form increase my time one hour per new employee. In itself this is not unreasonable but will this ever be necessary? Who is ever going to ask me to see these forms?

3836 Minnehaha Avenue Minneapolis, MN 55406 (612) 724-0474

OSHA has a regulation requiring that persons who work with blood, blood products or body tissues must wear protective clothing including gloves, masks, gowns and protective eyewear. As a distributor of these products we find that few, if any hospitals in our area are complying. Why?, it's expensive, hard to enforce with employees and not being enforced.

The bottom line is why pass a regulation that will not be, or if it is, is so expensive to enforce that the cost outweighs the benefit?

I have spoken to my peers and all are in agreement that this regulation represents a serious concern for the small business. Is anyone in Washington listening?

Very sincerely,

James W. Greenlee, PhD,
General Manager.

Opportunity Workshop Inc.

Main Building:
5500 Opportunity Court
Minnetonka, MN 55343 938-5511

North Building:
7400 Laurel Avenue
Golden Valley, MN 55426 541-1845

Clara Doerr-Lindley Hall Residence:
1717 2nd Avenue South
Minneapolis, MN 55403 870-4440

Jorgensen House:
3444 Girard Avenue South
Minneapolis, MN 55408 [illegible]

February 22, 1989

Mr. Peter Coyle
C/O Senator Rudy Boschwitz
U.S. Senate
Washington, DC 20510

Dear Peter:

Thank you for taking time to talk with me last week at the Twin West Chamber of Commerce luncheon. Because of the flurry of activity at the meeting, I wanted to restate my question in writing; about the effect of "Section 89" on Work Activity Centers and Sheltered Employment programs such as Opportunity Workshop.

Most of the individuals that work and receive services at Opportunity Workshop are covered by Medical Assistance for health care. While increasing numbers of the people we serve are placed in part or fulltime community employment programs, many are involved in long term employment programs at Opportunity Workshop. In this situation we are unclear whether or not we should be including these individuals in the discrimination testing that we are required to do.

I am hoping that either you or Senator Boschwitz would be able to determine the Congressional intent and the IRS interpretation, to help us comply with the law.

Thank you for your help and consideration.

Sincerely,

Bruce Bester

Bruce Bester
Controller

BB/cc

Equal Opportunity Employer

Accredited by Commission on Accreditation of Rehabilitation Facilities

ELECTRO INDUSTRIES, INC.

2100 W. RIVER STREET • P.O. BOX [illegible] MONTICELLO, MN [illegible]
(612) [illegible]

February 2, 1989

Senator Rudy Boshwitz
United States Senate
506 Hart Building
Washington, D.C. 20510

Dear Senator Boshwitz:

This is now 1989 and we must start living with the effects of Section 89. I know the purpose of the bill is good and we are in favor of the concept, but isn't there an easier way to comply?

We are a small manufacturing company with thirty employees and for 15 years we have offered a group health insurance policy. This year we had planned to go one step further and offer our employees a Cafeteria Plan (also called Flex Plan). But the complexities of administering Section 89 are so great we have decided that we are not only not going to offer a Cafeteria Plan, but we are also going to get out of the health care business by dropping our group policy. We have come to the basic decision that our main purpose is to provide jobs, not provide health insurance.

Since Sept. 1, I personally have spent several hundred hours dealing with a 60% increase in premiums, finding out we are uninsureable by every other company that insures in Minnesota, exploring the possibility of a Cafeteria Plan and trying to learn about Section 89. In addition you add the hours of other managers with whom I have shared and discussed ideas and the dollar cost is huge.

An example of the complexity is that we charge each employee 25% of their premium whether it is single or family. Since we get billed according to their age, and since we have singles, two-party and family rates, it gets burdensome to run a discrimination test on each category. In addition we can not pass the 80% test when we have to include those employees who do not use our insurance because they are covered by their spouse's employer. In addition we have several employees who are threatening to terminate their insurance coverage because they do not want to pay even their 25% of the premium. Since we are a small business we can not get an insurance policy which has an open end enrollment. Only large companies can get such a policy.

I believe Section 89 is hurting the very people it was suppose to help. I beg you to do something about it.

Sincerely,

Merrlyn L. Seefeldt

Merrlyn L. Seefeldt

Electrell Load Management Products

Martin County Republican Committee
Second Congressional District
Minnesota

SENATOR RUDY BOSCHWITZ
506 HART SENATE OFFICE BLDG
WASHINGTON, D.C. 20510

JAN 19, 1989

DEAR RUDY:

This with regard to section 89 of the Internal Revenue Code.

I called your office in Washington and talked with Peter Coyle. He advised that you had attempted to get the implementation delayed in the technical corrections bill with no luck. He suggested that I contact Senator Durenburgers office in that he was of the opinion that the bill was O.K.as it was. I did make the call and was advised that they too felt the bill was too complex to accomplish the desired end result.

We sell group benefits in the agency and in an attempt to be a good agent and be of help to our insureds, I have spent some 30 hours at various seminars, one having been conducted by an IRS agent. The only conclusion I can come to is that this is way too complex to be justified. I have checked into the matter of getting software to do the testing and other paperwork required in the program. The cost is $4,500 to $5,000 and takes about 10 megabytes on a computer. Hardly something that one wants to invest in just to take care of one segment of a tax return. Small business cannot afford to do it and so far, those advertising to provide the paper work have as a minimum cost $750.00. This a requirement for each and every business just for the privelage of providing group benefits for their employees.

At a time when most small employers in rural America are having a hard time paying premiums as it is (have had a number of them that had 40 and 45% increases in their group health benefits this year), and with those in legislative bodies bemoaning the fact there are so many uninsured people, such a forced added expenditure seems very counterproductive.

I realize that the bottom line of this proposal was to raise tax revenues. Why not just call a spade a spade and use the existing tax mechanism to accomplish this end result instead of causing a large added expense for the business community that is supposed to provide jobs and all the other benefits.

I would ask that you exert whatever effort you can to get this implementation delayed and then simplify the program so that it can be taken care of without such added work and expense.

Sincerely,

Duane Roloff,

Worthington
Ready Mix Concrete, Inc.
1000 Sherwood Street – P. O. Box 698
Worthington, Minnesota 56187
Phone 507-376-4707

January 19, 1989

NFIB
Abe Schneier
Suite 700
600 Maryland Ave. S.W.
Washington, DC 20024

Dear Sir: RE: "Section 89" law

I am a bookkeeper for Worthington Ready Mix, Inc., which is a small business in Southwestern Minnesota.

According to what I understand, this "Section 89" law could wreck havoc with my personal financial life, not only my employers!.

My husband works for a larger company which offers group health insurance and he and his family are covered there with a good policy which is paid for mostly by the employer, but a $50.00 deduction per month is withheld from my husbands check. I therefore do not want medical health benefits through my employer. I have been told by my CPA that I may have to take coverage under the medical plan offered by my employer also, to comply with the law. If I have to be covered under my employers plan, then part of the premium will be deducted from my wages - which I cannot afford!. My employer cannot afford to cover me if I receive no benefits from it. Two independent companies for insurance are not going to pay double benefits if my husband or I am hurt - so having double coverage is a waste.

What are those stupid people thinking of when they pass laws like this!

I hope NFIB can help to straighten out this mess before it gets any worse!

Thank you,

Ruth A. Shore, Bookkeeper

Ruth A. Shore

rs
cc Rudy Boschwitz

Ready Mix Concrete, Heated for Winter Use – Aggregate – Gravel Fill – Reinforcing Steel – Wire Mesh

MERCHANT, GOULD, SMITH, EDELL, WELTER & SCHMIDT
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PATENT, TRADEMARK & COPYRIGHT LAWYERS
SUITE ONE THOUSAND
NORWEST CENTER
SAINT PAUL, MINNESOTA 55101
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BRIAN H. BATZLI
DAVID R. TELLEKSON
HALLIE A. FINUCANE
JOHN J. GRESENS*
D. RANDALL BOYER
* NOT ADMITTED IN MINNESOTA

OFFICES IN MINNEAPOLIS
AND ST. PAUL

FRANK D. MERCHANT ([illegible]-[illegible])
RALPH F. MERCHANT ([illegible]-[illegible])

TELEX [illegible]
TELECOPIER (612) 298-[illegible]

January 31, 1989

Senator Rudy Boschwitz
U.S. Senate Office Building
Washington, D.C. 20510

Re: Taxation of Employee Benefits

Dear Rudy:

I am writing to you to express my grave concern over the tax legislation (particularly Section 89 of the Federal Tax Code) that prohibits the granting of various employee benefits (e.g. health insurance) to high paid professionals unless the same benefit plans are made available to the majority of all employees (i.e. the so-called "non-discrimination rules").

Aside from the personal difficulty in thoroughly understanding all of the implications of the new legislation, I have been participating in discussions within my own firm and with others outside our firm which strongly suggests that the legislation will not have its desired effect of extending benefits programs to all employees, but rather will cause certain benefit programs to be reduced or entirely eliminated for cost and other reasons.

Compliance with legislation, particularly in terms of Employee Benefit Plans, is becoming increasingly expensive and the result in our own firm has been a gradual, but accelerating deterioration in the level of benefit plans available and the cost of their administration. Someone in government is trying social engineering concepts without understanding the realities of the marketplace.

Senator Rudy Boschwitz
Page 2
January 31, 1989

Consider for a moment our own situation.

We currently employ over 150 people of whom approximately 50 are attorneys. Of the 50, less than half are officers (partners) and they collectively own the business. We provide employment in three different cities and the firm continues to expand.

We have a defined benefit Pension Plan geared at a nominal level of 50% of final average salary. When our Pension Plan is combined with Social Security benefits, lower paid staff employees receive a significantly higher percentage of their income at retirement than do the attorneys. As you know, legislation passed during the past few years has placed a cap on the amount of Pension and Profit Sharing benefits that can be provided to high paid professionals. Consequently, there is already a dramatic distortion of benefits (as a percent of compensation) in favor of lower paid employees. Consequently, those in a decision making position think twice about adopting any new benefit plan if the plan is weighted heavily in favor of the support staff and does not fairly benefit those who perform legal services which generate the income of the firm.

The law that became effective January 1, 1989 with regard to medical insurance and medical reimbursement plans (Section 89) may represent the "straw that broke the camel's back". Rather than provide all employees with the extended benefits that have been available to officers, there is a growing sentiment to provide only minimal benefits for everyone and use whatever extra funds are available to increase salaries of those who have historically been given improved medical benefits as one of the few fringe benefits available to higher paid professionals/owners.

At your convenience, I would like to discuss this matter in more detail because I believe it has far reaching implications and in the long run the government and the public will all be the losers. Current efforts to mandate uniform benefit plans should be rescinded.

Warm personal regards,

Cecil

Cecil C. Schmidt
CCS:vw

BERGER
AGENT ALLIED VAN LINES

March 27, 1989

1989 APR -3 [illegible] 49

U.S. Senator Rudy Boschwitz
Senior Republican, Committee on Small Business
United States Senate
Washington, D.C. 20510-2302

Dear Senator Boschwitz:

We are pleased to learn of your efforts to protect Minnesota business from added business expense that will result from complicated provisions in the 1986 Tax Reform Act, Section 89.

Our company provides without cost single and family medical coverage to all full time employees (35 hours per week). The added burden of Section 89 could result in our charging employees or possibly eliminating our medical insurance plan.

We support your efforts to simply delay implementation so the Internal Revenue Service can clear up matters and simplify reporting.

Sincerely,

BERGER TRANSFER & STORAGE, INC.

Thomas J. Miller
Director of Administration

TJM/mds

TRANSFER & STORAGE
2950 Long Lake Road, St. Paul, MN 55113 • 612-639-2260
Branch offices:
Newark, CA 415-794-7711 • Dallas, TX 214-638-3980 • Sheboygan, WI 414-458-2155 • Northlake, IL 312-409-0044
Grand Rapids, MI 616-281-3660 • Austin, TX 512-834-7777 • Minneapolis, MN 612-788-9393